INDIA'S STERLING POSITION AND THE WAR

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SOME ASPECTS

OF THE

Economic Consequences of the War For India.

Thesis approved for the Degree of Doctor of Philosophy in the University of London.

BY

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PREFACE.

The following pages are the result of the research work carried on by the writer at the London School of Economics for the Ph.D. degree of the London University, in the Faculty of Economics, in addition to the advanced training received in that institution. Any writer on the Economics of the War has to grapple with stupendous difficulties under the present conditions. The economic effects of the war cannot be said to have been over yet; the economic conditions are still so fluid that it is no exaggeration to say that they are changing almost from day to day; the documentary material and evidence available in the case of India is scanty and one-sided; we are too near the picture to obtain a proper perspective; and consequently it is most difficult to arrive at any definite conclusions, which will not be partially upset in a comparatively short time. It may therefore seem that for a task such as the one which has been attempted in these pages, it would have been preferable to wait for some years, until economic conditions had settled down, ample material had been available, and a proper perspective of the whole picture had been obtained. These considerations are no doubt weighty, but there are very important considerations on the other side. The ignorance of educated Indians regarding the vital economic

affairs of their country, with the exception of those few who have made a special study of economics, is appalling; yet it is most fortunate that recently they have begun to take a keen interest in economic matters, and there is ample evidence to show that they are anxious to know what the economic position of their country is at the end of the greatest war which the history of the world has known, and to obtain a lead in forming their own judgment upon the economic affairs of their country. But, unfortunately, there exists some danger of this popular interest withering away for the lack of suitable nourishment. The scattered, scanty and unintelligible information conveyed by Government publications is of little use to the Indian public. The number of well-written and authoritative books on the economics of India is very small, and most of these even are the result of the attempts to explain the official views rather than of independent investigations. Moreover, many Englishmen, although mostly ignorant of Indian economic conditions, have begun to feel considerable interest in them, partly for the purposes of trade with India, and partly because, since the war, the affairs of this country have loomed larger in public discussions in England. In the interests of India, it is most desirable that this interest should be properly fed and further stimulated, and that the English public should be made acquainted with the different points of view on economic questions pertaining to India. Examining all these factors, it appeared to the writer

that the balance of advantage lay on the side of attempting the task fulfilled in these pages now, and gaining for it some current and practical value, rather than of deferring it for some years, when it would possess only a historical importance.

Another relevant question was, whether the task should be attempted in India or in England. In the former, there are the valuable advantages resulting from the conduct of investigations on the spot, and from keeping in direct touch with the progress of events and the public discussions. But, the great disadvantage is that in India, possibly excepting Calcutta, the ordinary citizen cannot get access to all the Government records and publications, which he can consult in London at the India Office. Moreover, the conduct of investigations in England possesses the advantage of securing valuable and authoritative help in the application of general economic principles to Indian conditions. Here too, it was necessary to reckon the balance of advantage, and it appeared that it lay on the side of attempting the task in England.

Dr. Marshall always used to impress upon his students at Cambridge that the professed economist was wise not to express himself at all in public on politics, although he should express his views on the economic side of political questions, and that if he did do so, he

was bound to keep his economic science separate from it. However, in the present conditions of India, it is very difficult to draw a clear-cut line of demarcation between economics and politics, and in a few cases, the completion of an economic analysis necessitates an appreciable encroachment upon the field of politics. But, an endeavour has been made to restrict the following pages as far as possible to pure economics and the economic side of political problems, avoiding all politics as such. Moreover, as these pages are the result of independent investigations carried on in the academic atmosphere and environments of an educational institution, it is evident that they have not been written to explain, support, or represent any particular points of view or interests, existing in India or elsewhere. Endeavours have been made to support the statements and conclusions in these pages by means of figures, wherever possible. This has been particularly difficult, many of the tables have been specially framed from scattered Government statistics, and some of them have taken a considerable time to compile.

The writer is indebted to Dr. E. Cannan, Professor of Political Economy in the London University, and a distinguished authority on the subject, for valuable guidance in the application of general economic principles to Indian conditions, and to Mr. W. H. Moreland, C.S.I., C.I.E., I.C.S. (retired), whose writings on

Indian economic problems are well known to those interested in them, for going through this work, and making several valuable suggestions. His thanks are also due to the officials of the Record and Finance Departments of the India Office for giving him free access to all the Government records and publications required by him.

S. G. PANANDIKAR.

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* Only the more important sources are here indicated.

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INTRODUCTION

The outstanding characteristic dominating all the aspects of India's economic life during the last three decades has been that the country has been passing through an industrial revolution, similar in many respects to the one, which took place in England during the early part of the last century, and later in the other countries of Western Europe. During this period, India has been in a state of transition from the old archaic economic order to the new and reorganised order, typified by that prevailing in England. Though the transformation is still in its earlier stages, the change, which has already taken place, is most striking. In 1892, when the first signs of this industrial revolution were just beginning to be perceptible, the late Mr. Ranade, the pioneer economist in India, described the economic conditions of the country in the following words: "With us an average individual man is, to a large extent, the very antipodes of the Economical man. The Family and the Caste are more powerful than the Individual in determining his position in life. Self-interest in the shape of the desire of Wealth is not absent, but it is not the only nor the principal motor. The Pursuit of Wealth is not the only ideal aimed at. There is neither the desire not the aptitude for free and unlimited competition except within certain predetermined

Again, this intereference was bound to result in economic losses as well as gains. It is therefore necessary to draw up a sort of balance sheet of these losses and gains, and to determine whether the war left India with a net economic loss or gain. A distinction, however, will have to be made between the present conditions and those in the near future, and the balance-sheet of present losses and gains will have to be modified according as the losses appear to be more or less permanent than the gains. This will be the last and the most important problem for examination in the following pages.

It will not be possible to deal with the problems raised above, without a detailed analysis and examination of the actual economic effects of the war upon India. Such an analysis has been attempted in the following pages, but it may be explained that it has been restricted to those factors, regarding which generalisations more or less affecting the whole country can be made. This is true of foreign commerce, organised industry, finance and banking, and public finance. Agriculture and handicrafts could not be treated effectively in a work of this nature, because they vary so much by localities, that all-India generalisations on them are not likely to serve any useful purpose. In order to deal effectively with them, India will have to be broken up into a large number of tracts, and they will have to be examined separately in each tract. Even the examination of

organised industry, prices and wages is not altogether free from this difficulty, and it may be explained that their analysis in the following pages is meant only to furnish a fairly correct idea of the conditions generally prevailing in the country as a whole, and that the actual conditions in particular parts of the country may be appreciably different from these.

NOTE.

The conversion of rupees into sterling throughout this work has been made at the rate of Rs. 15=£1.

VALUE OF INDIA'S TOTAL FOREIGN SEA-BORNE TRADE IN £ MILLION

	1913-4	1914-5	1915-6	1916-7	1917-8	1918-9	1919-20
Imports							
Private Merchandise	122.2	91.9	88.0	99.8	100.3	112.7	138.6
Government Stores	5.4	4.7	4.1	7.1	9.3	13.0	9.2
Total Merchandise	127.6	96.6	92.1	106.8	109.6	125.7	147.8
Exports.							
Private Merchandise.							
Indian produce	162.8	11893	128.3	158.0	155.6	159.6	206.2
Foreign goods (re-exports) ..	3.1	2.7	3.2	5.4	6.1	9.7	11.8
Total private Merchandise ..	165.9	121.0	131.5	163.4	161.7	169.2	218.0
Government Stores	.09	.4	1.4	1.4	1.6	1.0	3.8
Total Merchandise	166.0	121.4	132.9	164.8	163.3	170.2	221.8
Total imports and exports of merchandise (private and Government) ..	293.5	218.1	225.1	271.7	272.8	295.9	360.6
Net Imports of treasure							
Private (Gold) ..	15.5	5.6	—.8	8.8	13.3	—1.6	2.7
,, (Silver) ..	4.2	6.7	3.7	—2.2	.5	.7	—.3
Government (Gold)	..	—.5(a)	—.02(a)	—.02(a)	3.5	—2.0(a)	20.8
,, (Silver)	4.5	—.7(a)	—.5(a)	14.7	12.2	44.6	19.8
Total Treasure (Gold)	15.5	5.1	—.7(a)	8.8	16.8	—3.7(a)	23.5
,, ,, (Silver)	8.7	5.9	3.2	12.5	12.7	45.3	19.5
Total	24.2	11.0	2.5	21.3	29.5	41.6	43.0
Net exports of merchandise ..	38.5	24.8	40.9	58.0	53.7	44.5	74.0
Including Government Stores							
Excess of Exports	14.2	13.8	38.4	36.7	24.2	2.9	31.0

(a) Net exports.

CHAPTER I.

General Characteristics of Foreign Trade.

According to the economic theory of international trade, a nation's prosperity cannot be said to vary directly or at all exactly with the amount of its foreign trade, because the latter is determined by other factors besides productivity. It is regulated by the differences in the comparative costs of production, and the amounts of these have no necessary connection with efficiency, though it is true that the larger the output per head of population, the greater will be the variety of goods produced, and that the higher the degree of specialisation, the greater will these differences tend to become. Thus, it is theoretically possible that the foreign trade of a country may decline simultaneously with its economic advance, if that advance reduces its differential advantages in the costs of production compared with those of other countries, and that the opposite case may also happen. However, it would be palpably absurd to urge that these possible cases are at all likely. Under the circumstances of modern commerce, the increase in the foreign trade of a country per head of population does usually indicate its advance in economic efficiency, keeping aside counteracting causes such as the raising of tariffs, or co-operative influences

such as the cheapened means of transport.* The chief practical value of the above theory lies merely in the warning which it conveys against using the declining figures of trade relating to a few classes of the exports of a country, as indications of its economic decay, as a whole, or even in particular industries. In the case of India, the value of her foreign trade compares unfavourably with that of most of the principal countries of the world in relation to their respective populations,† and it would be difficult to assert that this fact is not one of the indications of her general economic inefficiency, which can be proved beyond doubt by other data. Again, the only way to examine the changes in the foreign trade of a country in the course of time, or to compare it with that of other countries, is to deal with percentages and the amount per head. But it should be borne in mind that in drawing any conclusions from the figures obtained in these ways the absolute amounts should also be taken into account, and that otherwise the conclusions may sometimes prove misleading.

During 1909-10 to 1913-14, the quinquennium preceding the outbreak of the war, India's foreign sea-borne trade expanded somewhat rapidly, and the expansion was most marked in 1912-13 and 1913-14. This period was one of a great development of trade and industry

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* Cf. Brassey and Chapman—Work and Wages, Vol. II, p. 2.

† See Appendix I.

in all the countries of Western Europe, in the U. S. A. and in Japan. The demands of these industrial populations for foodstuffs and raw materials produced in any part of the world benefitted agricultural countries like India. The trade during the four pre-war months, April to July 1914, was somewhat below normal on account of the legacies left by the previous year in the form of a partial failure of the winter rains in the United Provinces, a continuance of bank failures in Northern and Western India, and a glut of piecegoods due to overtrading. However, a favourable south-west monsoon promised an agricultural prosperity, and at the end of July 1914 there was every reason to anticipate that trade would have a really good year. Then came the war, and India, intimately connected with the markets of the world in recent years, could not be expected to escape its shock. All her recent economic development has been along the lines of a diminished isolation from the rest of the world, and therefore she was not able to escape from the consequences of that economic solidarity, which bound her closely with the outside world. Hence, it was natural that the effects of the war on India's overseas trade should be far-reaching. The extent of the catastrophe may be realised from the fact that the exports of merchandise during the eight war months August to March 1914-15, as compared with those during the same months of the previous year, fell off by 43 per cent and that the imports of merchandise similarly fell

off by 34 per cent. Several factors operated to bring about this enormous reduction in India's overseas trade In the first place, the cessation of commercial relations with the enemy countries had serious effects, because Germany had been India's best customer after the United Kingdom, both in the export and import trades, 10.3 and 6.9 per cent of India's export and import trades in 1913-14 being with Germany, as compared with 23.7 and 64.1 per cent with the United Kingdom. The cessation of India's exports to the enemy countries was more disastrous than that of imports, firstly because the exports had a greater value, and secondly because, while it was feasible to replace the imports to some extent by those from other sources, the enemy markets for Indian produce could not be replaced. The result was a serious fall in the prices of important staples, such as cotton, jute and oilseeds, and a considerable distress among the agriculturalists growing these crops. Secondly, the trade with the allied countries, such as France and Belgium, had to be curtailed, as they had become theatres of war operations, and their demand for Indian produce was reduced to a large extent. Thirdly, the Government imposed several restrictions upon the export trade with the neutral countries, in order to prevent Indian foodstuffs and materials capable of being used for war purposes from reaching the enemies through the neutral countries, and also to make the Indian supplies more easily available for military requirements. Fourthly, the tonnage available for trade

purposes was seriously reduced owing to the disappearance of the German and Austrian mercantile marines from the seas, and the impressment of a large number of vessels for military transport, and the neutral and Japanese shipping was not extensive enough to fill up the gap to any appreciable extent. Fifthly, the dislocation of the world's exchanges brought about by the war adversely affected India's foreign trade. However, the stability of the Indian exchange was maintained, owing to the measures taken by the Government and explained fully later on. Lastly, the raids of the German cruiser Emden, which wrought a considerable amount of destruction in the Bay of Bengal, and the menace of the 'Konigsburg' in the Arabian Sea checked for some months the export trade. *

During 1915-16 the effects of the crisis brought about by the outbreak of the war disappeared substantially, the trade adjusted itself to some extent to the new conditions, and a sort of war equilibrium, although an unstable one, was established. Although trade operations continued to cause a considerable anxiety, the special difficulties occasioned by the outbreak of the war, such as the run upon the postal savings banks and the Paper Currency Offices, had disappeared. However, the monsoon conditions were not very favourable. The South-West

* Cf. Cotton—Handbook of Commercial Information for India, p. 100.

monsoon arrived late, and was weak and irregular in the northern parts of the Bombay Presidency and in large tracts of the Punjab. Parts of Assam, Bengal and the United Provinces, on the other hand, suffered from excessive rainfall. The winter rains also proved inadequate and untimely in Northern India. Moreover, the factors mentioned above as adversely affecting the overseas trade continued to operate. The dearth of tonnage became more pronounced and freights rose higher. The freights from Calcutta to London rose 7 times and those from Bombay 11 times what they were at the beginning of the war. The necessity of the Government intervention and control was intensified, and although the policy of stimulating the export of some articles to the United Kingdom, the allied countries and those manufacturing munitions for the Allies, was pursued, the general effect of the Government control was to restrict the recovery of trade. The net result of all these factors, favourable and unfavourable, was that the export trade recovered appreciably, but that the import trade continued to decline. The export of total merchandise including the Government stores and re-export of foreign goods increased by 9 per cent, but the import decreased by 5 per cent, as compared with those in 1914-15 which contained eight war months. The recovery in the export of jute, gunny bags and cloth, raw wool, and tea in particular was noteworthy.

During 1916-17 the famine in tonnage became more serious, and at the close of the year the freights rose to 14 times their pre-war level. The rates from Bombay to London at the end of 1916-17, as compared with those a the close of 1915-16, rose by 90 per cent, and the rates from Calcutta 60 per cent. The rates to the Far East also increased, but not to the same extent as those to the Western ports on account of the greater activity of the Japanese shipping companies. Another adverse factor which began to operate from this time was the curtailment of the sale of Council drafts on the part of the Secretary of State for India, which introduced serious difficulties in the finance of trade operations, and which is fully dealt with in the chapters on finance. The monsoon this year, however, was particularly good. It came early, stayed late, and its distribution was exceptionally uniform. This was fortunate, because the winter rains were much below the normal. The crops therefore were on the whole better than those of 1915-16, and the out-turn was above the average of the pre-war quinquennial period. Moreover, other favourable factors, affecting both the export and import trades, began to operate from this time onwards. With regard to the former, as the demand for munitions of war rapidly increased with the progress of the war, and as the resources of the allied countries had become most severely taxed by this time, the demand for Indian produce and manufactures for war purposes became keen, and developed in intensity during the following years of

the war without any consideration of their prices. As the export of these articles possessed a supreme importance from the point of view of the conduct of the war, the Government of India had to take special measures to facilitate these exports, and exported a large value of these articles on its own account. In regard to the import trade, Japan and the U.S.A. began to display a considerable activity, and to secure the custom entirely lost by Germany and Austria, and to an appreciable extent by the United Kingdom on account of her concentration upon the war. Hence, the value of India's overseas trade in 1916-17 showed a substantial increase as compared with that in 1915-16, the exports and imports of merchandise increasing by 21 and 13 per cent respectively. Nevertheless, the value of the export trade did not yet recover completely from the effects of the war as it was 2% below that of 1913-14 the pre-war year, while the recovery of the value of the import trade was far from complete, because it was 16% below that for 1913-14.

In 1917-18 the demand on the part of the Allies for articles of vital and national importance continued. The monsoon was unusually good, the crops were on the whole satisfactory, and the surplus produce available for export was considerable. But the scarcity of tonnage made itself felt still more, and the freights continued to leap upwards, with the result that the overseas trade merely maintained the position reached in the previous year

the imports of merchandise being the same in value and the exports decreasing by only one per cent. Thus, although four official years had elapsed since the upheaval caused by the outbreak of the war, India's overseas trade, far from showing any expansion, did not even recover completely from the effects of the upheaval. This was specially so in regard to the value of the imports of merchandise. The result was that in this year India, which had hitherto held the second place in the Empire's trade, next only after the United Kingdom, had to give it up in favour of Canada.

The year 1918-19 was remarkable from the point of view of trade, as a large number of conflicting events were crowded into it. The first half of it was characterised by a considerable vigour in the production of munitions and the export of articles of national importance and high prices. These efforts, however, were checked by a silver crisis caused by the depletion of the Government rupee balances, and the rise in exchange and a still greater scarcity of tonnage. Nevertheless, the monthly figures of the overseas trade showed an appreciable increase. Then came the armistice, and the position changed completely. Military activities could not be reduced immediately, but private trade was suddenly curtailed, mainly because a large number of traders who had been gambling upon the protraction of the hostilities and a continued rise in prices, found their calculations upset,

and the unhealthy speculation met its deserved fate. To add to this, a scarcity began to prevail in large tracts in Bombay, the United Provinces and some other parts of the country, as the monsoon had failed badly. At this critical time, a fierce epidemic of influenza spread all over the country, exacted a toll of six million souls, besides incapacitating many millions for a considerable length of time, and thus seriously reduced the labour available for agricultural operations. The net result was that the year's exports of merchandise showed an increase of value of only 4 per cent over those of the previous year. The imports however fared better, and an increase of 12 per cent was recorded. Nevertheless, the value of the total exports of merchandise was only 2% above and that of the imports was still 2% below the figures for 1913-14. Moreover, even the small increase in the former case was almost wholly due to greater re-exports of foreign goods.

It is thus seen that until 1918-19 India's total overseas trade, far from showing any expansion, had not even recovered completely from the adverse effects of the war, even if only the value and not the volume of trade is taken into account. Moreover, this recovery in the value was mainly the result of the rise of prices in the case of the exports, and entirely so in the case of the imports. It is therefore important to eliminate the effect of the rise in prices. For this purpose, the value of the

exports and imports during the succeeding years should be calculated on the basis of the level of prices prevailing in 1913-14. The calculated values would then represent what the values of the exports and imports would have been, if the prices had remained on the same level as in 1913-14, the difference between the calculated values of the trade in the succeeding years and the value recorded in 1913-14 representing the variation due to the change in the volume of trade, and the difference between the calculated values and the actual values recorded in the same year representing the variation due to the change in prices. The official figures of the rise in average prices in respect of 61 articles of import and 50 articles of export as compared with the pre-war year 1913-14 are as follows.* :—

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	100	101	126	170	211	268
Exports	100	102	103	117	125	150

The following figures are of the recorded values of the overseas trade in total merchandise in £ million.

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127.5	96.5	92.1	106.8	109.6	125.7
Exports	166.0	121.4	133.0	167.9	163.3	170.2

* Review of the Trade of India, 1918-19, p. 2. The great discrepancy between the rise in the prices of imports and exports was not exceptional, because the same phenomenon occurred in the case of the Argentine Republic, the rise in the prices of her imports and exports in 1919 as compared with 100 in the pre-war year amounting to 300 and 170 per cent respectively.

From these two tables, the following figures of the value of the overseas trade in total merchandise calculated at the prices current in 1913/14, are obtained.

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127.5	95.6	73.1	62.8	51.9	46.9
Exports	166.0	119.0	129.1	140.9	130.6	113.5

These figures show that the volume of the imports declined continuously and rapidly and that the volume of the exports recovered to some extent in 1915/16 and 1916/17, but again declined considerably during the two subsequent years. The decline in the volume of the trade is also brought out by the following official returns of the tonnage of ships entered or cleared with cargoes from or for abroad.*

The tonnage of vessels engaged in the foreign sea-borne trade which entered and cleared at Indian ports in million tons.†

	1912-3	1913-4	1914-5	1915-6	1916-7	1917-8	1918-9
Tonnage of vessels entered	8.7	8.6	6.3	6.0	5.9	5.2	5.2
Tonnage of vessels cleared	8.8	8.8	6.5	6.1	6.1	5.6	5.2
Total	17.5	17.4	12.8	12.1	12.0	10.8	10.4

* Cf. Fuchs—The Trade Policy of Great Britain and Her Colonies since 1860, p. 97.

† Review of the Trade of India 1918-19 p. 77.

The progressive decline in the tonnage of vessels entered and cleared from 1914-15 onwards, as compared with the figures for the previous years, is striking. There would have been no reason for deprecating the decline in the volume of the exports, if their value had recovered in a couple of years from the effects of the war and then had increased substantially, for to sell dear and to buy cheap is what pays. The decline in the volume of the imports, consisting mainly of manufactured goods essential for a direct consumption or further production imposed serious hardships upon the people of the country, and demonstrated the dangers of the economic deterioration as a result of which India since the early decades of the last century, has largely become the supplier of raw materials for the industries of the Western countries, and the most valuable market for their manufactured goods. From the eighties of the last century Indian economists repeatedly pointed out the grave dangers of the excessive ruralisation of the country, and her almost complete dependence upon the foreign countries for essential manufactures, and the above figures of the rapid decline of the volume of the imports during the war give a practical and valuable proof of their contentions.

These figures also prove the inaccuracy of the belief, popularly held, and tacitly supported by Mr. Shirras and some official publications,* that India's foreign

* See Shirras—Indian Finance and Banking, pp. 16 and 50, Review of the Trade of India and the Financial Statement and Budget, 1918-19.

trade enjoyed an immense prosperity during the war. This belief is due to the abnormal increase in her favourable balance of trade brought about by a serious reduction in the imports. The increase in the balance had the effect of merely giving to her people large quantities of paper money and precious metals, which were largely hoarded, while the true test of an increase in the prosperity of a country lies in an increase in her consumption of goods, which go to make up a civilised standard of life.* A few traders especially in the capital cities, made large profits out of the war conditions, and this also has led superficial observers to believe that India gained an immense prosperity during the war, but there is no evidence of any general improvement in the standard of life in the country. Moreover, as will be explained in the concluding chapter of this book, if the war had not intervened, the pre-war expansion of India's foreign trade would probably have continued for some years, although perhaps at a somewhat slower rate.

The value of India's foreign sea-borne trade did not exceed the figure which it had reached in 1913-14, to any

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* The average citizen, untutored in economics, is still a victim of the old mercantilistic fallacy, and believes that the old mercantilistic phrases, 'favourable balance of trade' and 'unfavourable balance of trade' are to be taken literally. Frequently, it is even imagined that the only gain which a country as a whole can secure from foreign trade is in an excess of exports over its imports and an accumulation of money. The lesson of the experience of the U. S. A. during the war with an accumulation of gold shows that an accumulation of money in a country merely lowers the purchasing power of that money. See Fisher, Stabilising the Dollar, p. 179.

appreciable extent, until 1919-20. It was only in this year that it left the pre-war figure behind in a substantial degree, and marked some return to pre-war conditions. Tonnage became more abundant, many of the restrictions on trade were removed, and especially those on trade with ex-enemy countries, the markets of the world became more active, and there was a large demand for Indian produce on the part of Western countries for the reorganisation of their industries on a normal basis. However, the restrictions on the export of cereals had to be maintained, the course of trade was sometimes hindered by labour unrest in many parts of the world, and the rise in exchange was an unfavourable factor in the expansion of the export trade. Moreover, it would be incorrect to assume an increase in the quantity of exports and imports corresponding to the increase in their value as compared with that in 1918-19, and although the prices of some imported manufactures fell appreciably, for the majority of commodities a further rise in prices was an important factor in the case. Again, the increase in the value of exports was much more marked than that in the value of imports, the former being nearly double the latter. While the most valuable export in 1918-19 was jute, in 1919-20 its place was taken by cotton, raw and manuafctured, its total value being £58 million as against £30 million in the previous year. The export of raw jute increased from £8½ million to £16½ million, but the export of manufactured jute declined by £1. 8 million.

This expansion in the value of foreign trade, however, did not endure, and in 1920-21 the balance of trade moved against India, because, while she imported comparatively large amounts of manufactured goods not available during the war, her export trade received a substantial set-back for several reasons. Firstly, the embargo on the export of food-grains had to be continued on account of the unfavourable agricultural situation and their high prices. Secondly, the export of Indian produce, especially raw cotton, to Japan was considerably reduced on account of the serious financial and commercial crisis in that country. Thirdly, the economic situation in Central Europe became worse, largely on account of a further inflation of currency and depreciation of the foreign exchanges, the output of its industries and its exports did not improve, it could not obtain credits to any substantial extent, and consequently its ability to purchase commodities from other countries diminished considerably. This reduction in the effective demand on the part of Central Europe substantially affected India's export trade, as it has been a valuable market for Indian produce. Fourthly, the other European and the American markets were overstocked with Indian produce on account of its large import in the previous year and the inability of the industries of these countries to use it up fully, and consequently less Indian produce could be disposed of in these markets. Finally, the adverse effect of exchange fluctuations continued during this year also. Thus even in 1920-21 India's

foreign trade could not free itself entirely from the unfavourable effects of the war.

Having examined the general effects of the war on the value and volume of the foreign sea-borne trade of India, it seems desirable to proceed to compare them with those of the other principal countries of the world. However, the comparison will have to be restricted to the effects upon the values only of the trades of the several countries, because it is impossible to find out the volumes. The comparison will be useful in examining the validity of the argument of those who assert that India has benefitted from its ruralisation, *viz.* that the trade of agricultural countries suffers less from the shock of a war than that of manufacturing countries. Even to-day this argument is frequently advanced by those who have neglected a comparison of this kind. The following figures of the foreign trades in merchandise of the principal countries of the world will be found instructive for this purpose.

Value of imports and exports of merchandise of certain principal countries.*

UNITED KINGDOM £ million.

Year.		Total Imports.	Exports of Britsih produce.	Exports of foreign & colonial produce.	Total exports.
1913	..	768.7	525.2	109.6	634.8
1914	..	696.6	430.7	95.5	562.2
1915	..	851.9	384.9	99.1	483.9
1916	..	948.5	506.2	97.6	603.8
1917	..	1064.2	527.1	69.7	596.8
1918	..	1316.1	501.4	30.9	532.4
1919*	..	1631.9	798.1	164.3	962.7

*Provisional figures.

ITALY in £ million

Year.		Imports.	Exports.
1913	..	145.5	100.2
1914	..	116.9	88.4
1915	..	188.1	101.3
1916	..	335.6	123.5
1917	..	550.6	132.3
1918	..	641.5	133.8
1919*	..	660.7	207.5

* Provisional figures.

SPAIN £ million

Year.		Imports	Exports.
1913	..	47.2	39.9
1914	..	42.0	35.2
1915	..	48.3	50.3
1916	..	51.2	55.1
1917	..	53.1	52.1
1918	..	24.4	37.9

FRANCE. £ Million.

Year.		Imports	Exports
1915	..	441.3	150.3
1916	..	606.4	194.3
1917	..	652.5	153.5
1918	..	892.1	188.9
1919	..	1191.1	348.5

RUSSIA. Millions of roubles

Year.		Imports.	Exports.
1913	..	1374.0	1520.1
1914	..	1098.0	956.1
1915	..	1114.0	397.2
1916	..	1153.0	402.0

One million roubles euquals £ 105,735 7s.

SWITZERLAND. £ million.

Year.		Imports	Exports,
1913	..	76.8	58.0
1914	..	59.1	47.7
1915	..	67.2	66.8
1916	...	95.1	97.8

SWEDEN. £ Million.

Year.		Imports.	Exports
1913	..	46.6	45.0
1914	..	40.0	42.5
1915	..	62.9	72.5
1916	..	62.7	85.7
1917	..	63.3	86.5
1918	..	Not available	74.4

* Statesman's Year Book 1920 and Annual Year Books of several countries.

U. S. A. £ Million.

Year ended June 30		Imports.	Exports
1913	..	362.6	485.7
1914	..	378.8	465.9
1915	..	334.8	553.7
1916	..	439.6	866.7
1917	..	531.9	1258.0
1918	..	589.1	1183.9
1919	..	619.2	1445.0

ARGENTINE REPUBLIC £ Million

Year.		Imports	Exports
1914	..	64.5	80.6
1915	..	61.1	116,4
1916	..	73.2	114.6
1917	..	76.1	110.0
1918	..	96.2	165.3
		..	..

BRAZIL. £ million.

Year.		Imports	Exports
1914	..	35.4	46.8
1915	..	30.1	53.9
1916	..	40.4	56.5
1917	..	44.5	63.0
1918	..	52.8	61.2

JAPAN. £ million.

Year.		Imports	Exports
1913	..	72.9	63.2
1914	..	59.6	59.1
1915	..	53.2	70.9
1916	..	75.6	112.7
1917	..	103.6	160.3
1918	..	166.8	196.2
1919	..	196.2	209.9

EGYPT £ Million.

Year.		Imports	Exports
1914	..	21.7	24.1
1915	..	19.3	27.0
1916	..	30.9	37.5
1917	..	33.2	41.1
1918	..	51.2	45.4

UNION OF SOUTH AFRICA* £ million.

Year		Imports	Exports.
1913	..	41.8	66.6
1914	..	35.3	39.9†
1915	..	31.8	16.7
1916	..	40.4	23.8
1917	..	36.5	28.5
1918	..	49.5	32.9

CANADA Millions dollars.

Year ending March 31st.				Total Imports	Imports for home Consumption.	Total Exports.
1913-14	..	..	..	650.7	633.7	479.0
1914-15	..	..	..	629.4	587.4	490.8
1915-16	..	..	..	564.5	542.1	882.9
1916-17	..	..	..	(a)	873.4	1375.8
1917-18	..	..	..	(a)	962.5	1586.2
1918-19	..	..	..	(a)	916.4	1259.9

(a) No longer published.

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* Including bullion but not specie.

† About 15 million £ of gold, which in normal times would have been exported was retained in the country on behalf of the Bank of England. No information is available for later years.

AUSTRALIA.* £ Million

Years,	Imports	Exports Australian produce,	Exports Other Produce.	Total.
1913 ..	79.7	75.1	3.4	78.5
1914 † ..	39.8	36.3	1.7	37.9
1914-15 ‡..	64.4	58.1	2.5	60.6
1915-16 ..	77.5	71.8	3.0	74.8
1916-17 ..	76.2	95.1	2.9	98.0
1917-18 ..	60.8	72.0	30.0	75.0
1918-19 ..	93.5	103.7	3.1	106.8

INDIA. £ Million.

Year ending March 31st.	Imports	Exports & Re-exports.
1913-14	127.5	166.0
1914-15	96.6	121.4
1915-16	92.1	133.0
1916-17	106.8	164.9
1917-18	109.6	163.3
1918-19	125.7	170.2

An examination of the proportional loss or gain of the principal countries revealed in the above tables, leads to the conclusion that India has been one of the worst sufferers from the war, so far as foreign trade is concerned. Her import trade suffered more than that of all the other countries excepting Russia and Australia, and her export trade also suffered more than that of all the other countries except the United Kingdom, France, Russia and Australia. India thus shares with Russia and Australia the unenviable distinction of being hit hardest in trade matters, and this proves that the argument that the trade of agricultural countries is least affected by a war is not

* Including bullion and specie excepting 1917-18.

† First six months only.

‡ In 1914 the trade year was changed from the calendar to the financial year ending June 30.

applicable in her case. During the war, the scarcity of tonnage was the predominant factor and the vital consideration for agricultural countries was their proximity to or distance from Western Europe, the workshop of the world, to which their bulky raw materials must be shipped for disposal. The Argentine Republic, Brazil and Canada, the suppliers of foodstuffs and raw materials to the factories and workshops of Western Europe, and the U. S. A. which was such a supplier to a large extent, felt the adverse effects of the war in a far less degree than India, and even profited from it, on account of their shorter distance from Western Europe. They could export their raw materials to Western Europe and import manufactured goods therefrom with less shipping difficulties than India could do, and the figures of their export and import of merchandise were correspondingly affected. The fact that India was a supplier of raw materials failed to give her any advantage during the war, because she had to contend with far greater shipping difficulties.* It has already been explained that with the progress of the war the freights from Bombay and Calcutta to Western Europe rose rapidly and continuously. The trade of Australia, which is even more distant from Western Europe than India, was hit hard for the same reason. If the geographical situation of India with regard to Western Europe had been more favourable, her dependence upon agriculture would have been less objectionable from this

* Cf. Sargent—Seaways of the Empire, pp. 45 following.

point of view, although it would have remained open to serious objections from other points of view. But, situated as India is, the war has demonstrated the grave dangers of her dependence upon agriculture. The extent of the opportunities, which were open to India, rich as she is in raw materials of all kinds, if she had directed her attention to industrial development before the war, and which she threw away by neglecting that development, is shown by the table relating to the trade of Japan. While India's trade was painfully endeavouring till the cessation of the hostilities merely to recover from the adverse effects of the war, making it futile to expect its expansion, Japan's export trade had more than trebled, and her import trade had increased $2\frac{1}{2}$ times, by the time of the armistice as compared with what it was just before the commencement of the war.* Japan's trade exhibited this phenomenal expansion during such a short time, in spite of her unfavourable geographical situation, and her far greater dependence than India upon foreign sources of the supply of raw materials, probably because her people and Government were wise enough to realise the necessity of an industrial development before the war, and to utilise fully the

* It is true that Japan's commercial prosperity received a substantial set-back after the armistice, but there is considerable evidence to show that Japan is now recovering rapidly from the effects of the recent crisis, and it will be generally admitted that, in spite of the crisis, her commercial position is much stronger to-day than it was before the war. See, for instance, the Year Book of Japan 1920 and the Statesman's Year Book 1920. This factor should be borne in mind in considering later references to the effects of the war upon Japan's economic position.

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* Cf. Sargent—Seaways of the Empire, pp. 45 following.

point of view, although it would have remained open to serious objections from other points of view. But, situated as India is, the war has demonstrated the grave dangers of her dependence upon agriculture. The extent of the opportunities, which were open to India, rich as she is in raw materials of all kinds, if she had directed her attention to industrial development before the war, and which she threw away by neglecting that development, is shown by the table relating to the trade of Japan. While India's trade was painfully endeavouring till the cessation of the hostilities merely to recover from the adverse effects of the war, making it futile to expect its expansion, Japan's export trade had more than trebled, and her import trade had increased 2½ times, by the time of the armistice as compared with what it was just before the commencement of the war.* Japan's trade exhibited this phenomenal expansion during such a short time, in spite of her unfavourable geographical situation, and her far greater dependence than India upon foreign sources of the supply of raw materials, probably because her people and Government were wise enough to realise the necessity of an industrial development before the war, and to utilise fully the

* It is true that Japan's commercial prosperity received a substantial set-back after the armistice, but there is considerable evidence to show that Japan is now recovering rapidly from the effects of the recent crisis, and it will be generally admitted that, in spite of the crisis, her commercial position is much stronger to-day than it was before the war. See, for instance, the Year Book of Japan 1920 and the Statesman's Year Book 1920. This factor should be borne in mind in considering later references to the effects of the war upon Japan's economic position.

unprecedented opportunities, which the war presented, by carrying forward that development by all the means at their command.

The slow recovery of India's foreign trade was also partly due to the great difficulties of railway transport and the resultant congestion and confusion of traffic.* War conditions imposed a heavy strain upon the railway system, and the volume of traffic requiring railway transport continuously increased with the progress of the war. In the first place, a large amount of traffic had to be diverted from the sea to the railway routes on account of the growing shortage of coastal shipping resulting from the war. Secondly, the military traffic, consisting of troops, supplies and stores for overseas, and munitions and other traffic essential for the conduct of the war, continued to grow. Some idea of the growth in the demand for transport facilities may be obtained from the fact that at one period the preferential traffic including coal occupied 80 per cent of the total rolling stock. While the traffic increased in this way, the ability of the railways to handle it declined progressively. This was partly due to the fact that locomotives, rolling stock, rails and other materials and staff had to be supplied for the construction and working of the military railways in Mesopotamia and other theatres of war. But the main reason was that the Indian railway system was completely dependent upon the United

*Cf. Railway Administration Reports 1916-17 to 1918-19, Part I.

Kingdom, not merely for increasing its equipment, but even for all materials essential for the upkeep of its existing services. During the war it became extremely difficult to obtain any railway materials from the United Kingdom, whose workshops were engaged in the manufacture of munitions, and the Indian railway system, far from being able to increase its equipment so as to cope satisfactorily with the increasing demands made upon it, found it very difficult even to make good the wear and tear. Its stock of materials for this purpose, was gradually exhausted, and had the war continued longer, the effect on the general standard of the railway service would have been serious. It is true that the net receipts from the railways continuously increased during the war as explained later in Chapter IV, but this is rather an indication of the intense demand for railway facilities than of the efficiency of the railway system. It is certain that the receipts would have been greater, if the system had been able to meet the demand promptly and adequately. That the huge railway system of a vast country like India should be almost wholly dependent for the materials essential for ordinary repairs upon another country thousands of miles away, the supplies from which are bound to be cut off during critical times, is another indication of the fundamental industrial deficiencies of India. Here, also, as in several other directions, the war has taught the urgency of an industrial development in India. It is satisfactory to note that more energetic efforts are now

being made to make India more independent of outside sources in the supply of railway materials, and that the Government of India has undertaken to purchase in India annually for ten years a large number of waggons and other railway materials manufactured in the country.*

It has been argued that while the British Empire was engaged in a deadly struggle for its very existence, it was unreasonable to expect that the trade of India should have expanded during that critical period. This argument may be examined by comparing the foreign trade of India with that of the other important parts of the Empire. The export trade of the United Kingdom suffered more than that of India, but her import trade fared much better. The position of the United Kingdom, however, was exceptional, as she was the mainspring of the allied resistance to the enemy, and a large part of her imports was used for war purposes. On the other hand, the trade of Canada fared far better than that of India, her exports trebling and imports increasing 1½ times by the time of the cessation of the hostilities as compared with what they had been during the pre-war year. It has already been pointed out that in 1917-18 India, which had till then held the second place in the Empire's trade, next only to the United Kingdom, had to give it up in favour of Canada. It may be said that this increase in Canada's trade was facilitated by her proximity to the U. S. A. No

* Railway Administration Report, 1918-19, Part I, p. 20.

means of judging whether this was the case are available, but even if it was true, it does not affect the conclusion, namely that the war affected India's trade far more adversely than that of Canada. The import trade of the Union of South Africa fared a little better than that of India; it is not possible to draw any conclusion with regard to the export trade, because no information is available regarding the export of gold bullion, which being mined in the country, is one of her staples of export. The trade of Australia even, hampered as she was by her unfavourable geographical situation, fared somewhat better than that of India. Hence, it does not seem unreasonable to expect that the trade of India should have shown some signs of an expansion during the war and not merely of recovery.

The result of the examination of the effects of the war upon India's trade has been mainly unfavourable so far. However, the enquiry reveals an encouraging feature, namely an increase in the proportion of the exports of fully or mainly manufactured goods as compared with the exports of foodstuffs and raw materials.

This is brought out by the following figures :—

The value of Indian export trade in private merchandise according to four main classes in £ million.

	1913-4	1914-5	1915-6	1916-7	1917-8	1918-9	Percentage. 1913-4	1914-5	1915-6	1916-7	1917-8	1918-9
I. Food, drink and tobacco ..	43.2	32.6	..	38.0	50.5	42.2	26.5	27.6	..	24.1	32.5	26.4
II. Raw materials and articles mainly unmanufactured ..	81.6	53.4	..	67.1	55.2	57.7	50.1	45.1	..	42.4	35.5	36.1
III. Articles wholly or mainly manufactured ..	36.4	33.1	..	51.3	48.5	58.5	22.4	26.2	..	32.5	31.2	36.6
IV. Miscellaneous	1.6	1.2	..	1.6	1.4	1.5	1	1.1	..	1	.8	.9
Total ..	162.8	118.3	..	158	155.6	159.9	100	100	..	100	100	100

However, it may b? po'nted out that on a closer examination, it appears that this feature is not so encouraging as it seems to be at first sight. In the first place, it is not extravagant to hold that India's trad: should have made a greater advance in this direction. The extent of the opportunities for this advance afforded by the war, is

revealed in the figures of Canada's trade, which achieved a much greater progress in increasing the proportion of the export of manufactured goods. While this proportion in the case of India's trade increased from 22.4 per cent in 1913-14 to 31.2 per cent in 1917-18, it increased from 19 to 43 per cent during the same period in the case of Canada's trade. This is shown by the following table :

Values of classes of exports of merchandise from Canada in million dollars. *

	1912-3	1913 4	1914-5	1915-6	1916-7	1917-8
Produce of						
mines ..	57.4	59.0	51.7	66.5	85.6	73.7
fisheries	16.3	20.6	19.7	22.4	24.9	32.6
forests..	9.8	9.5	9.4	7.8	8.3	10.3
Animals & their produce.	44.8	53.3	74.4	102.9	127.8	172.7
Agricultural produce	150.1	198.2	134.7	249.7	373.4	567.7
Manufactures ..	77.2	90.8	118.8	285.5	525.0	678.3
Miscellaneous.	0.1	.1	.6	6.8	6.3	4.7

In the second place, it is likely that a part of this increase in the proportion of manufactured goods in India's exports will vanish with the return of normal trade conditions. The increase during the war was brought about by abnormal conditions, and was mainly the result of much larger exports of manufactured jute and leather

* Statesman's Year Book.

goods, the values of their exports increasing from £ 18.8 and 2.8 million respectively in 1913-14 to £ 35.1 and 6.5 million in 1918-19. The large increase in the export of gunny bags and cloth was entirely for military purposes, and with the end of the war this abnormal demand has ceased. Another, though a much less important, factor is connected with the fact that during the war the English Government temporarily sacrificed the interests of the Dundee jute mills by encouraging the Calcutta jute mills to manufacture and export far larger quantities of jute goods, because the shipment of the raw jute from Calcutta to Dundee, and that of the goods manufactured from it from Dundee to the theatres of war operations, would have taken up much more tonnage than the shipment of jute manufactures from Calcutta to the war theatres, at a time when the saving of as much tonnage as possible was the supreme consideration. The war being ended, the Dundee mills will in all probability regain their pre-war normal position, and it is likely that a part of the normal increase in the world demand for jute manufactures in the near future over the pre-war demand will be met by the Dundee mills. Again, labour difficulties and the possibilities that some substitute for jute may be found should not be ignored altogether. The increase in the export of leather manufactures also was, to a very large extent, for military purposes, and was encouraged by the English Government in order to save the tonnage, although the leather industry in India was not on quite a sound

basis, the methods of tanning hides and manufacturing goods being somewhat crude and lagging behind the progress made in the Western countries. This military demand has ceased, and further, with the return of normal conditions, the German leather industry will re-appear in the market, the English industry has been freed from its war restrictions, and the American industry has been strenuously endeavouring to secure a larger share of the European trade in this commodity. It is therefore likely that the world market for leather manufactures will again be largely secured by the leather industries in these three countries, and that India will in a substantial measure resume its pre-war position of the supplier of the raw hides and skins to them. However, a part of the gain achieved by India during the war will probably remain, as endeavours are being made to place the industry on a sound footing, and to enable it to compete with its rivals in the other countries, by the adoption o' the latest methods of tanning and manufacturing, and by a proper organisation of the industry.

The great lesson taught by the war to India from the trade point of view is thus the urgency of her industrial progress. The vital need of the fullest attention to this problem becomes still more evident from a comparison of the value of the total trade in merchandise per head of the population in India and Japan How far the general belief mentioned above, in the prosperity of India's trade in recent years, is correct, will be realised from the fact

that, while the value of the total trade of Japan in merchandise per head of the population was nearly equal to that of India just before the Russo-Japanese War, by 1913 it had advanced to £2.55 per head of the population, and still further to £6.36 by 1918, the value of the total trade of India in merchandise per head of the population being £0.94 in 1913-14 and £0.95 in 1918-19.* A comparison between the economic progress in Japan and India in recent years leaves the impression that the main reason why Japan, while she was in the same position as India in 1904, left her behind in 1913, and far behind in 1918, is the fact that, while the people and Government of Japan endeavoured harmoniously to foster her industrial progress by all the means at their command after the Russo-Japanese War, those in India comparatively neglected such a progress.†

CHAPTER II.

Recent Tendencies in the Distribution of Foreign Trade and the Policy of Imperial Preference.

A. The Distribution of India's Export Trade.

From the beginning of this century upto the commencement of the war, the flow of India's export trade showed a tendency towards a diversion from the United

* Financial Annual of Japan 1919.

† See Count Okuma's "Fifty Years of New Japan."

Kingdom to Continental Europe, especially Germany, and to the U. S. A. and Japan. During the war this flow was made to revert from Continental Europe to the United Kingdom and the British Empire by artificial means; and the war being ended, endeavours are being made to prevent the kind of diversion which [took place before the war, and to secure a larger share of India's exports for the United Kingdom and the British Empire by other artificial means. Therefore, it is desirable first to consider the causes of the pre-war diversion, and how far it benefitted India, and then to examine the artificial way in which the trade was made to revert to the United Kingdom and the British Empire, and how far this reversion was conducive to the interests of India, and finally to examine the other artificial means, by which it is sought to maintain and increase this reversion. In order to understand the present position, it is necessary to examine in some detail the tendencies which prevailed before the war.

At the beginning of this century, 29 per cent of India's exports were taken by the United Kingdom, 25 per cent by Continental Europe, 24 per cent by the Far East, 7 per cent by the U. S. A., and the remaining 15 per cent by other countries. By 1914 the share of the United Kingdom had fallen to 24 per cent, and that of Continental Europe had increased to 29 per cent, the Far East took 17 per cent, mainly owing to a large decrease in the export of opium and cotton yarns to China, the U. S. A. 9 per cent,

and other countries 21 per cent. Germany, which stood third in the list of India's customers in 1900, taking £5 million of Indian produce, attained the second rank in 1914, next only to the United Kingdom, importing £17.5 million of India's produce. The relative rapidity in the growth of Indian exports to Germany becomes evident when these figures are compared with £20.5 and 38.5 million of Indian produce taken by the United Kingdom in 1900 and 1914 respectively. Japan, whose share was £4.2 million in 1900, standing 6th on the list, increased her share to £15.1 million, and reached the third place. The U.S.A. took £5 and 14.5 million of Indian exports in 1900 and 1914 respectively. Belgium, Italy, France and Austria also increased their shares.

Till the closing decades of the 19th century, although a freedom of trade prevailed since 1813, the other nations did not make any special efforts to develop direct trade relations with India, and the United Kingdom carried on a considerable entrepot trade in Indian produce, fulfilling the function of a distributor of the produce among other countries. This pre-eminence in India's export trade was the result of unrivalled facilities which she enjoyed in India. She was politically supreme in the country; the export of bulky raw materials from India depended mostly upon the British shipping, as the shipping of other nationalities occupied in the Indian trade was insignificant; most of the exporting and importing

mercantile houses were English; so were the Exchange banks, which conducted the financing operations; the railways in India were built with English capital and managed by English companies; the Government of India pursued the policy of encouraging the cultivation of wheat, long-stapled cotton, jute, tea and linseed, with a view to increase their export to the United Kingdom. These and other similar facilities enabled the United Kingdom to carry on a lucrative trade as the distributor of the Indian produce.

The situation, however, began to change from the closing decades of the last century, as the other nations, thitherto content with receiving a part of the Indian produce through the United Kingdom, began to direct their attention to the advantage of endeavouring to dispense with the services of the United Kingdom as a distributing agent, by developing direct trade relations with India. This desire was stimulated by other considerations also, such as the advantages which would be secured for pushing the sale of their manufactures in the Indian market, and for obtaining larger quantities and better qualities of Indian raw materials for their own industries. Germany, which had set her own house in order and commenced a rapid industrial advance by 1890, led the way, and was followed by Japan, which redoubled her activities in this direction after the Russo-Japanese war. The U. S. A. and France also made similar endeavours, which, however,

were not in any degree comparable with those made by Germany and Japan. The two former countries, to a considerable extent, remained content to deal with India through London, and to utilise the available English services.

The organisations established by these countries to develop direct trade relations with India were meant to secure the facilities which the United Kingdom enjoyed, and received the whole-hearted support of their respective Governments. In the first place, special efforts were made to develop the carrying trade with India, so as to be able to reduce the dependence upon the services of the British shipping. Thus the tonnage of the German shipping engaged in the Indian trade increased from 208,000 tons in 1900 to 854,000 tons in 1914. The Japanese shipping increased from 32,000 to 294,000 tons during the same period. It is true that these figures are far smaller than the increase of the British shipping engaged in the Indian trade from 3.3 million tons in 1900 to 6.4 million tons in 1914. But it is the comparative rapidity of the development in the first two cases, which deserves notice, as indicating the general tendency, and not the absolute figures. However, the French shipping engaged in the Indian trade during 1900-14 did not increase, but merely remained fairly steady at 90,000 tons, with a couple of jumps to 100,000 tons, while the U.S.A. continued to be conspicuous by the absence of any shipping of their own. Secondly,

mercantile houses for conducting the import and export business were established by Germany, Japan and Austria at the chief Indian ports, Calcutta, Bombay, Karachi, Madras and Rangoon. It is true that the main object in organising these houses was to push the wares of the respective countries in the Indian market, but the houses directed their attention also to the export trade, and it should be noted that before the war India continued to export more to these countries than to import from them. France and the U.S.A., however, continued to deal with India through the English houses. France had no particular stimulus for establishing houses of her own, because her exports to India consisted mainly of articles of luxury such as wines and silk goods, the sale of which could not be pushed much further, on account of the low standard of living of the country resulting from her general poverty; and the U. S. A. did not pay much attention before the war to the possibilities of foreign trade, on account of the great value of the home market. Thirdly, the efforts of the mercantile houses to increase the trade of their countries with India were admirably supplemented by those of the respective consulates in India, which gathered valuable commercial information regarding the possibilities of expanding trade with India, and disseminated it among the houses in India as well as in their own countries. Fourthly, successful attempts were made by these countries to dispense with the services of the English exchange banks in financing the trade, by the

organisation of their own banks, with branches in all the important trade centres in India. Thus Germany established the Deutsche Asiatische Bank, Japan the Yokohama Specie Bank, France the Comptoir National, and the U. S.A, the International Banking Corporation.

The result of all these measures was that free and extensive markets outside the United Kingdom and the British Empire were developed for Indian produce, and that the United Kingdom lost the buyer's monopoly, which it had largely held before. This wide circle of customers enabled India to secure the fullest value for her produce, and her trade tended to flow more to these countries, and away from the United Kingdom. India was dependent upon other countries, chiefly the United Kingdom, for the manufactures essential for civilised life, and her capacity to purchase them depended upon the surplus of her produce which was available for export, and upon the value realised for it. So the trade being unrestricted, India exported more to the other countries than she imported from them, and the full value secured for her produce enabled her to purchase large quantities of manufactured goods, especially from the United Kingdom.

This comparatively satisfactory state of affairs was considerably altered by the war, during whose progress the flow of Indian export trade was made to revert from Continental Europe to the United Kingdom and British Empire. As has been explained before, all commercial

relations with the enemy countries had to be prohibited, several restrictions were imposed upon the export trade with neutral countries, in order to prevent the Indian produce reaching the enemy countries through them, the export of some kinds of the produce from India was prohibited in order to make them available in India for military purposes, and special measures were taken to stimulate the exports to the United Kingdom and some other parts of the British Empire. The exports to Belgium ceased on account of the military occupation of that country by the enemy, and the exports to France were considerably reduced on account of the occupation of a part of the country by the enemy, and the economic dislocation caused by the war. The result was that the share of the United Kingdom in India's export trade increased from 24 per cent. in 1913-14 to 28 per cent in 1918-19, that of the other parts of the British Empire from 17 to 24 per cent, while that of France was reduced from 7 to 3 per cent, and that of the other foreign countries, excluding the U.S.A. and Japan, was reduced from 23 to 13 per cent. The export trade however did not divert from the U. S. A. and Japan, which increased their shares from 9 per cent each to 13 and 12 per cent respectively during the same period. There were several causes for this increase. In the first place, they enjoyed all the privileges of being allies, and at the same time escaped from most of the handicaps and difficulties, which were experienced by the Allies in Europe. Secondly, India became far more dependent

upon imports from them, on account of the difficulty of securing goods from the United Kingdom and the other European countries, and consequently more exports tended to be shipped to them. Thirdly, the demand on the part of the other countries for Indian produce not capable of being turned to military use was considerably reduced on account of the serious reduction of the normal industrial activities, and India could dispose of the excess produce not required by the other countries, only by selling it to the U. S. A. and Japan, which, and especially the latter, were the least pre-occupied with the conduct of the war or handicapped by it, and the most concerned with the progress of the normal industrial activities. Fourthly, Japan during the war successfully carried forward her work of establishing national organisations in India for developing direct trade relations with her, and the U. S. A. also made a substantial progress in the same direction. The Japanese shipping activities in the carrying trade of India became far more important, and the Japanese steamship companies such as the Nippon Yusen Kaisha, the Osaka Susen Kaisha and the Yamashita Kisen Kaisha organised several new lines of services, with the result that the tonnage of the Japanese vessels engaged in India's foreign sea-borne trade increased from 294,000 in 1913-14 to 671,000 in 1918-19. The U. S. A., which, as explained before, was conspicuous by her absence before the war, made a beginning, and the tonnage of her vessels entering the Indian ports in 1918-19 was 37,000. Then Japan

organised more mercantile houses in India, such as the Mitsui Busen Kaisha and the Japan Trading Company, with numerous branches and extensive connections, and more banks for financing the trade, such as the Sumitomo Bank and the Bank of Taiwan, with branches in all the important trade centres.

The result of the reversion of a substantial part of India's export trade from Continental Europe to the United Kingdom and the British Empire was that India had to sell a large part of her produce in a restricted market and although the prices rose during the war, and India secured a much higher value for her produce than she did before the war, she could not obtain the fullest value for her produce, which she could have done, if she had been able to sell her produce in a free world-market. This, however, was inevitable in the case of a belligerent country in war-time. Moreover, although India secured higher prices for her exports, she had to pay far higher prices for her imports; for, as explained before, the average prices of the exports by the end of the official year 1918-19 as compared with those in 1913-14 had increased only by 50 per cent, while the average prices of the imports had increased by 168 per cent; and it has already been mentioned that the capacity of India to buy essential manufactured goods from other countries depends upon the value which she realises for her surplus produce available for export.

The restriction of the market for the Indian produce was unavoidable and necessary during the continuance of the war, but on the conclusion of peace, the general expectation was that the course of India's export trade would be allowed to resume its pre-war freedom, and to flow to those countries which offered the best value for its staples. Efforts are, however, being made to maintain the reversion of India's export trade from Continental Europe to the United Kingdom and the British Empire that was brought about during the war, and to effect a similar reversion of the trade from the U.S.A. and Japan. The war being ended, the artificial means which brought about the reversion had to be abandoned, but other means more suited to peace times, and going under the name of Imperial Preference, may be substituted to achieve the same object. What these means are, will be considered in another section, and we may for the present turn to an examination of the import trade.

B. The Distribution of India's Import Trade.

From the beginning of this century up to the commencement of the war, India's import trade, like her export trade, showed a tendency towards a diversion from the United Kingdom to Continental Europe, especially Germany, the U. S. A. and Japan. During the war, as explained above, the flow of the export trade was made to revert from Continental Europe to the United Kingdom and the other parts of the British Empire.

But this did not happen in the case of the import trade. This trade with the enemy countries ceased althogether, and with the other countries of Continental Europe was considerably reduced, but the advantage did not accrue to the United Kingdom, from which the import trade showed a more pronounced tendency to divert than before the war. The custom lost by Continental Europe and the United Kingdom was secured by Japan and the U.S.A., to which the import trade exhibited a remarkable tendency to divert during the war. Since the end of the war, this diversion of the import trade from the United Kingdom has been substantially reduced, but the recovery is not yet complete, and efforts are being made to check this diversion further and to redress completely the reduction in the relative position of the United Kingdom in the import trade by artificial means. Hence, it is desirable to measure the extent of this diversion and to determine its causes, and then to examine how far the adoption of the artificial means will be conducive to the interests of India.

In 1899-1900 the share of the United Kingdom in India's import trade was 69 per cent, while those of Germany, the U. S. A. and Japan were quite small, amounting to 2.4, 1.7 and .6 per cent respectively. By 1913-14 the share of the United Kingdom had fallen to 64 per cent, while those of Germany, Japan and the U.S.A. had increased to 6.9, 2.6 and 2.6 per cent respectively. Thus during this period Germany secured

nearly as much of the share of the import trade as the United Kingdom lost; Japan's advance, although not so rapid as that of Germany, was substantial, while U.S.A. also showed a noticeable tendency in the same direction. The causes of this diversion were the same as those which led to a similar diversion of the export trade. As these causes have already been examined at some length, it will be sufficient to state here that, from the early years of the last century till its closing decades, England possessed an undisputed industrial supremacy, and that this, combined with her political supremacy in India, practically enabled her to monopolise this valuable market so far as the import of manufactured goods was concerned. From that time however, Germany commenced a rapid industrial advance, and searching for new foreign markets, she saw the enormous opportunities offered by India. The various national organisations, which she began to establish with state help in connection with the Indian trade, and which have been already explained, enabled her to utilise these opportunities. In fact, these organisations were established more with the purpose of securing a larger share in India's import trade than for increasing her share in the export trade; and although India continued to export more to her, than to import from her, by means of these organisations, Germany developed a considerable export trade with the Indian market. During the quinquennium preceding the war, Germany, having gained a firm footing in the Indian

bazaars with her goods substantially cheaper than the English goods, was rapidly increasing her trade with this market, and if the war had not intervened, the United Kingdom would soon have had to face a formidable competition with Germany in her staple articles of export to the Indian market.

This success on the part of Germany was the result of her skilful manipulation of the power placed in her hands by the national organisations. Thus, some of the German firms in India by means of a close co-operation secured a virtual monopoly of the export trade in certain kinds of produce, particularly hides, and were enabled by the large and sure profits made therefrom to extend their business, and to take risks in connection with it, by establishing numerous branches in the various parts of the country, in a way which they could not have otherwise done. Further, the German merchants and manufacturers quickly recognised that as the standard of living of the masses in India was low on account of the general poverty of the country, cheapness and outside appearance of the goods to be offered for sale in the Indian market were far more important than their quality and lasting properties, and consequently that it was useless to offer to the masses goods of a superior quality at high prices, when their low incomes made it necessary for them to buy the goods of a poor quality because they were cheap; and that goods gaudily and brightly finished would be

more in demand than goods not so attractiv , although more lasting. They also recognised that as the masses were under the influence of many curious ideas and superstitions, it was a much better business to attempt to manufacture for them what they required than to endeavour to educate them into purchasing what the manufacturers thought they ought to have required. Having thoroughly grasped these principles of a successful business in the Indian market, they put them into practice with great energy and astuteness. Agencies were established in the principal trade centres, and the agents personally canvassed the bazaars, however small, gave full facilities to dealers for viewing complete sets of samples, accepted the smallest orders, obtained a first-hand information regarding the requirements of the masses, and communicated it to the manufacturers in Germany. Having manufactured the kinds of goods required by India, the German manufacturers granted more facilities to the Indian dealers in them than the English manufacturers did. The former usually quoted prices c. i. f. any Indian port, which included all the charges upto the arrival of the goods at the Indian port, and enabled the Indian dealers to estimate their expenses accurately, while the English manufacturers frequently quoted a f. o. b. rate, which left the dealers in the dark as to the expenses of bringing the goods from the manufacturer's works to the Indian port, and consequently as to their total expenses. Secondly, the German firms granted greater credit facilities to the

Indian dealers than the British firms did. The dealers generally preferred D. A. (documents against acceptance) to D. P. (documents against payment) drafts, and the German firms nor merely met this demand, but frequently granted extended credits over lengthy periods, if the bills could not be paid at maturity.

Japan also made a similar use of her national organisations for extending the sale of her wares in the Indian market. Her efforts however were not in any degree comparable with those of Germany, because the main concern of the Japanese manufacturers, after the Russo-Japanese War of 1904-5 was to extend their markets, nearer home, in Korea, Manchuria and China.

During the war the goods of Germany were entirely eliminated from the Indian market. They were, however, replaced not by those of the United Kingdom but by those of Japan and the U. S. A., which, in addition, enormously increased their exports to India, and secured a substantial part of the market exclusively held by the United Kingdom before the war. The extent of this change will be realised from the fact that the share of the United Kingdom in India's import trade fell from 64 per cent in 1913-14 to 46 per cent in 1918-19, while the shares of Japan and the U. S. A. in the same years increased from 2.6 per cent each to 20 and 10 per cent respectively. This serious reduction in the share of the United Kingdom in India's import trade, as also the simultaneous increase in her share

in the export trade considered before, are explained by the same cause, *viz.* the concentration of all the industrial resources of the United Kingdom upon the manufacture of goods required for military purposes. Her demand for raw materials capable of being converted into munitions of war became much more intense, and consequently the export of such produce from India to her increased. But she could give far less attention to the manufacture of goods required for non-military purposes, and consequently the export of such goods to India was considerably reduced. During the first two years of the war, a certain amount of English goods was available for export to India, even though the quantity so available for export to India had become substantially reduced. But during the last two years of the war, the English government for the purpose of releasing the English factories as much as possible for war work and of conserving tonnage, prohibited the manufacture of goods for India, and shipping them to her, without priority certificates and licenses, which were issued only on the recommendations of the Indian Munitions Board, forwarded by it only if the goods in question were urgently required in India, and could not be manufactured at home or obtained from the U.S.A., Japan, or elsewhere. *

* During 1919-20 the United Kingdom recovered a substantial part of the share in India's import trade, which she had lost to Japan during the war, the share increasing from 46 per cent. in the previous year to 51 per cent. The share of the U.S.A., however, increased from 10 to 12 per cent.

The elimination of the Central Powers from the Indian market, and the inability of the British manufacturers to supply it fully, opened wide opportunities to other industrial countries, of which Japan and the U.S.A. made an excellent use. Although both these countries had paid an increasing attention to the Indian market from the beginning of this century, they had not fully realised its value before the war as explained above, because the U.S.A. possessed a large home market, while Japan was engaged in extending her markets nearer home in Korea, Manchuria and China. The war made them realise fully the value of the Indian market, and a new spirit began to pervade their organisations. It could be translated into practice, chiefly because both these countries, Japan from the first, and the U. S. A. from 1917, enjoyed all the privileges of being Allies, without the handicaps and difficulties, which the European Allied had to contend with. The first thing to do was to find out more fully the exact requirements of the Indian market. For this purpose, both Japan and the U. S. A. sent commercial travellers and inquiry agents, who travelled in all the parts of India, studying the Indian requirements and arranging to match well-known qualities of English goods. Japan also sent many commercial missions to India, which conducted their enquiries privately, without being accredited to the Government of India. Secondly, both the countries established a number of export and import houses, with branches in the important sea-port towns. The activities

of the several branches of the Mitsui Bussan Kaisha and the Japan Cotton Trading Company in the case of Japan, and of the Steel Products Export Company, the Angus Company and Grace Brothers in the case of the U. S. A., were developed on a very large scale, and numerous smaller firms were established to carry on a similar work. In addition, Japan established retail stores in all the fair-sized towns of India. These mercantile houses and their agents flooded the Indian dealers with commercial literature of various kinds, such as price lists, catalogues and market reports, and gave full facilities for viewing complete sets of samples. Thirdly, the facilities for financing the trade with India were largely extended. Thus, numerous facilities were afforded to the importers of American goods by the International Banking Corporation, and also by the New York and San Francisco Banks. The same assistance was rendered to the importers of Japanese goods by the Yokohama Specie Bank and the newly-created Sumitomo Bank and the Bank of Taiwan, with branches at the main Indian ports. Fourthly, the shipping facilities also were enormously improved. Before the war, the Japanese shipping companies carried on a restricted service between India and Japan, but during the war regular and direct lines of steamers were inaugurated between India and Japan and the other important parts of the world by the Nippon Yushen Kaisha, Osaka Shosen Kaisha and Yamashita Kisen Kaisha, which established offices at the Indian ports. It should be mentioned that

none of the Japanese services required the movement of ships in the danger zones, excepting the Osaka Shosen Kaisha's service between Bombay, Genoa and Marseilles, which, however, was established only towards the middle of 1918, when the Suez Canal ports had become so choked with goods awaiting transhipment, deposited there by the Japanese ships which refused to enter the Mediterranean, that Japan had to choose between the alternatives of either running her ships through the Mediterranean or abandoning all efforts to develop her trade with the Continental ports. Consequently, Japan was able to maintain her shipping intact, and to increase her service in safe waters, from which all the available ships were withdrawn by the Allies in Europe, to combat the submarine warfare and to maintain their essential supplies. The shipping facilities between India and the U. S. A. also were considerably improved. The Ellerman and Bucknall and Andrew Weir S.S. Comapanies, and the Japanese Nippon Yusen Kaisha inaugurated and maintained a regular service between the Atlantic and Indian ports. The Pacific Mail S. S. Company did the same between the Pacific and Indian Ports. Thus both the Atlantic and Pacific coasts could contribute to the expansion of American shipments to India. The U. S. Emergency Fleet Corporation also occasionally ran steamers between the Atlantic and Indian ports. Fifthly, although the American manufacturers and merchants had not much experience of the Indian market before the war, they adapted themselves

to its requirements in a remarkable way, by pursuing thorough business methods, giving personal attention to the dealers through representatives, and endeavouring to give them satisfaction in all respects. Japan, however, was far less successful in these matters, and the dealers frequently complained of shipments being below the quality of the basis samples, late shipments, the failure to carry out the packing or shipping instructions, mistakes in drafts and documents, the late arrival of documents, the failure to answer business letters, and in general deficiency in business methods. But, Japan contrived to make it up by a close combination of all her commercial interests. The most remarkable feature of the Japanese organisation for the development of foreign trade was the way in which all the branches of her commercial activity, the mercantile houses, the banks and the shipping companies, assisted by the Japanese Government, combined closely for the furtherance of the national interests, and, by means of the preferential treatment of their own people as against foreign competitors, managed to secure business for each other, and to keep it out of the hands of their foreign rivals. This cohesion of all the interests for the furtherance of the national welfare was carried to an extent, which was not achieved by any other nation, not even by commercial Germany before the war.

It now remains to consider the prospects of the distribution of India's import trade in the near future.

The trade of Germany and Austria with India consisted largely of cheap showy goods, and this trade has been almost entirely secured by Japan. These goods have not competed seriously with the British goods, as even before the war, English manufacturers in the main preferred the production of the finer qualities of the goods. Although Germany and Austria have been allowed an access to the Indian market, it is improbable that they will regain their former position, and Japan will probably retain most of this bazaar trade, because it is peculiarly suited to Japanese conditions of industry based upon cheap labour, the price not the quality of the goods being the sole desideratum. Owing to the heavy taxation, economic dislocation and labour unrest, the cost of production in the Central countries has enormously increased, and indeed it is difficult to see how any European nation will in the near future be able to compete with Japanese cheap labour in this kind of trade.

But the trade of the Central countries with India in superior goods has also been secured by the U. S. A. and Japan, which, in addition, have made material inroads into the staple trades of the United Kingdom with India, the former into the metallurgical and the latter into the textile trades, and the question of considerable importance for the United Kingdom is how to recover fully this valuable ground lost during the war. It is believed by some that, as Japan and the U. S. A. secured a part of the Indian market simply on account of a large recduction

in the competition of the United Kingdom, and not on account of any kind of industrial or commercial superiority over her, the United Kingdom will have little difficulty in completely regaining this market. But a closer examination of the actual position leads to the conclusion that the American and to a less extent the Japanese competition has come to stay and will be insistent. In the first place, the competition of the U. S. A. and Japan has revolutionized the buying methods in India. Before the war, the United Kingdom possessed a virtual monopoly of the Indian market in many articles, and could depend upon getting at home all the orders of the Indian dealers and the managing agents of the various industries, as they had buying connections with the United Kingdom only. But, during the war, the connections with her had to be abandoned, or became considerably weakened, while similar connections with Japan and the U. S. A. were formed and strengthened, and these two countries are doing their best to foster them. Secondly, both these countries possess very efficient and wide-spread organisations in India for pushing the sale of their products. The American import and export houses mentioned above are very powerful firms, with widespread connections. Moreover, even the British import and export houses are a great asset to the U. S. A. As it was possible to obtain only American goods in certain kinds of trade during the war, these houses directed all their energies to the sale of the American goods, and, with the large profits made

owing to the prevailing scarcity, expanded their sales organisation. Hence, some of these houses have at present far more efficient and extended organisations for pushing the sale of American goods, than they had for distributing English goods before the war. It may be thought that, the war being ended, they will transfer their energies to the sale of the latter. But it may be pointed out that these British houses are above all cosmopolitan in their interests, and devote their attention to the sale of the goods of any country, which yields them the greatest return for their services. Herein, their attitude is in a marked contrast to that of the Japanese houses. They have built up strong interests in the distribution of American goods, have made large profits from them, and they are not likely to abandon them for the sake of the United Kingdom, unless the latter is able to offer them more profitable terms. The leading Japanese mercantile houses in India possess large financial resources and widespread connections all over the world. There is not a single British house in India, which can claim the financial resources, the political influence or the extensive organisation possessed by the Mitsui Bussan Kaisha, which has a paid-up capital of £ 8 million, branches throughout the world, and is so closely connected with the Japanese Government, banking, shipping and industrial institutions, that it may fairly be said to be a semi-official institution Other Japanese mercantile houses in India, though smaller, possess a considerable financial backing, political

influence, and connections all over the Far East. All these houses are intensely national in their aims, and are prepared to undergo material sacrifices for pushing the sale of the products of their country. Moreover, they have a very great advantage in the low scale of their working expenses, as, on account of the Japanese standard of living being substantially lower than that of Europeans, they can obtain assistants and clerks from Japan at much lower salaries than those paid by the European houses to their employees. Lastly; the Indian dealers and the managing agents of industrial concerns have realised that the American business methods are no less efficient than the English, and in some trades the opinion even seems to be that the former give more satisfaction. It is true that, as explained before, the same cannot be said of the Japanese methods. But, it has been generally admitted that her position in the textile trade is more sound. In this trade there is a far greater regularity and conformity to basis samples than in other trades, and also a much greater attention is successfully given to please the buyer in other respects. This seems to be due to the fact that the textile industry in Japan has been a well-organised factory industry for some time, whereas many other industries are still in the domestic stage or have just left it. It should be remembered that it is the textile industry which has been the United Kingdom's staple trade with India, and that it is in this trade that considerable inroads have been made by Japan, and that

the Japanese competition in the near future will probably continue to be substantial. Further, the disadvantage to the Japanese competition in India's import trade in other goods, resulting from the deficiency of its business methods will be largely counterbalanced by the peculiar advantages derived from the patriotic combination of all the Japanese commercial interests.

These considerations have not been set forth to assert that the U. S. A. and Japan will retain the same position in the Indian market that they secured during the war. It is true that this position was largely the result of the withdrawal of the United Kingdom from the Indian market to a considerable extent, and that the position of Japan, as explained above, has received some set-back since the cessation of the hostilities, which has enabled the United Kingdom gradually to resume her normal industrial activities. The above considerations have been emphasised merely to show that the U. S. A and to a less extent Japan will maintain a much more powerful position in the Indian market than they did before the war, although less so than they did during the war, and that the United Kingdom will find it extremely difficult to resume her pre-war position in that market.

It thus appears that the virtual monopoly in the Indian market which the English manufacturers enjoyed as regards many articles before the war has disappeared for good. India has now become a highly competitive market, and the English manufacturers and merchants

must devote as great and painstaking attention to it, as they would to any other market, where they may be struggling to obtain a substantial share of the trade. It will be a very difficult task for them to recover fully the share in India's import trade, which they have lost since the beginning of this century, and more especially during the war. The Trade Commissioner for the United Kingdom in India has come to the same conclusion after an elaborate enquiry,* and the English manufacturers and merchants themselves realise the immense difficulties of the task. They have begun to improve their organisations in the directions, in which their Japanese and American rivals have developed their organisations with considerable success, but it is recognised that it will be still very difficult for them to recover completely the share in India's import trade, which they have lost to Japan and the U.S.A., unless they secure some special advantage, which cannot be obtained by their rivals. Such an advantage will be granted to them, if the policy of Imperial Preference is applied to India's trade, and therefore the economic aspects of this policy may now be briefly examined.

C. IMPERIAL PREFERENCE.†

It was explained in the last section but one that from the beginning of this century India's export trade showed

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* The Present Conditions and Prospects of British Trade in India.

† It is obvious that Imperial Preference is not purely an economic doctrine. It is largely, perhaps mainly, political. Its purely political aspects do not concern these pages, which deal only with its economic aspects, and the following criticism of the doctrine is based on the economic principles governing it.

a tendency towards a diversion from the United Kingdom to Continental Europe, U. S. A. and Japan, that during the war it was made to revert from Continental Europe to the United Kingdom, and that the problem now is how to maintain this position and to effect a similar reversion from Japan and the U. S. A. Then, in the last section it was seen that India's import trade also showed a tendency to divert from the United Kingdom to Germany, Japan and the U. S. A. from the beginning of this century, that during the war the diversion to Japan and the U. S. A. became far more pronounced to the serious detriment of the United Kingdom, that her recovery of this loss is not yet complete, so that the problem before her now is how to effect a full reversion of this trade from these two countries. In this section it will be first examined how the policy of Imperial Preference, although it may be applied to India's trade on other grounds, will have the result of assisting the United Kingdom in the solution of the double problem, which confronts her to-day, and then it will be considered whether the policy will be conducive to the economic interests of India.

The Government of India is not free to pursue its own fiscal policy, which is directed by the Secretary of State for India, who is responsible to the House of Commons. The Government of India therefore has virtually been made partially to accept the policy of Imperial Preference with regard to India's foreign trade, and this policy is likely to be put into force in three ways: firstly, by levying a

substantial duty on the export of certain kinds of Indian produce with a rebate of most of the duty, if the produce is exported to any part of the British Empire; secondly, by prohibiting the import of certain articles from any territory outside the Empire, unless the articles in question are not available, or cannot be purchased at reasonable prices, within the Empire; and thirdly by levying duties on the import of certain goods, with a rebate of most of the amount, if the goods are imported from any part of the Empire. The first two methods have already been partially put into operation, the first being applied to the export of raw hides, upon which a duty of 15 per cent has been imposed, with a rebate of 10 per cent on the hides exported to any part of the Empire, and the second to dyestuffs.

The Government of India has been made to apply the policy of Imperial Preference to India's foreign trade on the ground that the war has taught the Empire the valuable lesson of self-sufficiency, and that each part of the Empire should perform its share in the achievement of this object, which is calculated to strengthen the Empire, economically, financially as well as militarily. These pages are not concerned with the military aspect of the question, but an examination of the application of the policy to India leads to the conclusion that it will fail to achieve the object of strengthening the Empire economically and financially, and that it will merely benefit some other parts of the Empire, and especially the United Kingdom, at the expense of India. In the first place, it seems that it will

have the effect of assisting the United Kingdom substantially to solve her above-mentioned double trade problem. The first method of the policy will artificially check the export of Indian produce to foreign countries, and stimulate it to the other parts of the Empire, and especially to the United Kingdom, which imports much more Indian produce than all the other parts of the Empire put together. The second and third methods will artificially check the imports from foreign countries into India, and stimulate those from the other parts of the Empire, chiefly from the United Kingdom, which supplies almost the whole of the manufactured goods which India imports from the Empire. Secondly, the economic strength of the Empire is made up of the strength of its several parts, and the Empire can be so strengthened only by strengthening all its parts. If any part is left economically weak and dependent, it will be a source of great weakness to the Empire as a whole. Consequently, if any policy is applied to any part of the Empire on the ground of the necessity of strengthening the Empire as a whole, and if it can be proved that such a policy will have the effect of weakening that part economically, the policy cannot be accepted as serving to strengthen the Empire, and requires to be deprecated as tending merely to benefit some other parts of the Empire at the expense of that part. An enquiry into the probable effects of the application of the policy of Imperial Preference to India's foreign trade leads to the conclusion that it is likely to leave India

economically weaker and more dependent than she is at present, and that therefore the policy will probably fail to strengthen the Empire as a whole.

It seems that the application of the first method of carrying out the policy of Imperial Preference explained above will have the result of forcing India to sell some of her produce in a restricted market, in which she will secure lower values than those she can obtain elsewhere. This may considerably impair her capacity to purchase abroad the manufactured goods essential for civilised life and economic progress, because it has been explained before that her capacity to do so depends upon the values that she can secure for the export of her produce. This method involves another danger also. The grant of a substantial rebate of the export duty will make it profitable or the other parts of the Empire to import the produce in question, and then to sell it to foreign countries at the full prices prevailing in the world, and thus to pocket the difference, unless the same amount of the export duty is levied in the other parts of the Empire also. For instance, the existing 10 per cent rebate of the duty on the export of hides would probably help to concentrate the Indian hides trade with the Continent of Europe in some convenient centre in the United Kingdom, and the trade with the U. S. A. in a similar centre in Canada, and thus may benefit these centres at the expense of India, and the sacrifice that India has been asked to undergo for the sake of strengthening the Empire

will have been made in vain. The imposition of export duties in the United Kingdom and the self-governing Dominions corresponding to those levied in India, in order to obviate this danger, is improbable, as these countries fully control their own fiscal policy.

The second method of putting the policy of Imperial Preference into operation will force India to buy some of the manufactured goods necessary for her economic advance in a restricted market, in which she may have to pay higher prices than those which she need pay, if she is allowed to buy freely in a world market. She will thus have to put up with a double loss. Her capacity to purchase the essential goods, which may be impaired, as explained above, by her having to sell her produce partly in a restricted market, will probably be still further impaired by her being obliged partly to buy also in a restricted market. This double loss is likely to check the expansion of her foreign trade, which compared very unfavourably with that of most of the other principal countries of the world before the war, and which has been one of the worst sufferers from the war. It is true that theoretically a provision will be made for granting licenses to import goods into India from foreign countries, if the goods are not available, or cannot be purchased at reasonable prices, within the Empire, but there seems to be some reason to fear that the provision may not have much practical effect. For, although such a provision existed in the case of dyestuffs, the Indian

Merchants' Chamber of Bombay has stated that applications for licenses to import certain kinds of dyestuffs from the U. S. A. were rejected, although they were not manufactured in the United Kingdom or any other part of the Empire, and that similar applications for licenses to import certain other dyestuffs met with the same fate, although the prices of the stuffs manufactured in the United Kingdom were substantially higher than those of the same qualities manufactured in the U. S. A.* Furthermore, even if the prices of such articles are not substantially higher in the Empire than in foreign countries, India will be a loser to the extent that the prices are higher in the former than in the latter, if she is forced to buy them from the former. Another danger also is involved in the application of this method. Unless the prohibition of the import of certain articles from foreign countries in the case of India is applied to all the other parts of the Empire, there is nothing to prevent any of them from buying the articles in question from foreign countries and selling them to India at a profit. But, it is impossible to apply the prohibition to the United Kingdom and the self-governing Dominions without their consent, as they enjoy complete fiscal autonomy.

The third method of carrying out the policy of Imperial Preference has been advocated on the ground that it will promote India's economic development and

* Annual Report 1919.

self sufficiency by affording a valuable stimulus to her industrial progress. This would be true, if the duty were to be substantial, say 15% ad valorem, and if the same duty were to be levied upon imports of all goods of the same kind coming from all countries without any distinction. But the grant of a rebate of a large part of the duty, say 8 or 10 per cent ad valorem, in the case of the imports from the other parts of the Empire will have the effect of giving them a considerable artificial advantage over foreign countries in the Indian market, without giving any appreciable advantage to India's new and struggling industries, which, if they are to be protected at all, require to be protected as much against the superior competition of some parts of the Empire, and especially the United Kingdom, as against that of foreign countries. The only effect of the application of this method will probably be to force India to purchase some of her necessaries of life in a restricted market at higher prices, without granting any corresponding advantage to her struggling industries.

Towards the end of 1919, the Government of India, after a considerable controversy in the Legislative Council, appointed a committe to report on the subject of Imperial Preference, and its report was issued in April 1920. The committee expressed the opinion that the adoption of a system of Imperial Preference would entail the raising of the import duties against foreign nations, and would be likely to prove injurious to the consumer in India, by causing some rise in the prices of imported commodities.

Looking to the profit side, the number of commodities in India's export trade, which might be expected to benefit from an increased market within the Empire, appeared to the Committee to be limited. Its conclusion, therefore, was that India was neither likely to gain nor to lose appreciably on the balance, by the adoption of a moderate preference in India's import duties. This was only its provisional conclusion. It felt its inability to give an authoritative opinion on the subject, and so recommended the appointment of a commission with powers to take evidence from all the interests affected by the subject. The committee adopted a right attitude towards the problem, but it was weak and halting, and it is difficult to accept its conclusion that India would neither gain nor lose appreciably from Imperial Preference, because it has been explained above that it is likely to cause considerable harm to the country.

The best chances of solving the problem, how to strengthen India economically, so as to strengthen the Empire as a whole, seem to lie in the grant of fiscal autonomy to the Government of India, and in leaving it free to determine its own trade policy for the country. It has been provided in the Reform Act that the Secretary of State should so far as possible abstain from any intervention in fiscal matters, when the Government of India and the Indian Legislature agree, and should only intervene to safeguard the international obligations of the Empire or any fiscal arrangement within the Empire, to which His Majesty's Government

may be party. However, these important qualifications are likely to take away much of the reality of the fiscal power thus granted to the Government of India. What seems to be needed is that an untrammelled fiscal freedom should be granted to the Government of India, in the same way as it has been given to the self-governing Dominions, and this will enable it to frame, with the assistance and sanction of the reformed and enlarged Indian Legislative Assembly, a trade policy in the true economic interests of India and the Empire. It appears that this goal will be reached in a comparatively short time.

CHAPTER III.

Industrial Development.

Although the great necessity for the revival of India's old industries and the establishment of new ones has been perceived by Indian economists since the eighties of the last century, the popular realisation of it, and the demand for an industrial development, dates from the beginning of this century. The foundation of this movement is the recognition of the poverty of the people. Many writers have endeavoured to prove it by elaborate calculations of the average income per head of the population, but, as Mr. Moreland points out, such statistical artillery is

quite unnecessary.* It is universally acknowledged by those, who have any knowledge of Indian conditions, that the general standard of life in the country is very low, that the masses of the population are badly housed, clothed, doctored and taught, and often overworked and underfed, and that the present income of the country, even if equitably distributed, would not suffice to provide for even a reasonable standard of life. This general poverty is undoubtedly due mainly to the undue preponderance of agriculture as a means of livelihood, and to the consequent dependence upon the vagaries of the monsoon, which is often deficient. Some idea of this preponderance may be obtained from the fact that, while the proportion of persons employed in industries and in agriculture is 8 to 1 in England, and 3 to 4 even in Ireland, it is 2 to 13 in India. Hence a deflection or a premature cessation of the monsoon currents may bring about the sudden loss of the income of large areas, and acute distress to their rural population, requiring for its relief the expenditure of millions of pounds on the part of the Government. This state of affairs is very unsatisfactory, and, although the natural resources of the country are such that some preponderance of agriculture must be expected to continue, it is generally admitted that the existing degree of its preponderance is altogether excessive. Each successive experience of the poverty of the masses and of the periods of drought, gives a fresh

* Quarterly Review, April 1917.

support to the urgent necessity for the diversification of employment insisted on by the Famine Commissions of 1880 and 1901.

However, the industrial movement was not very successful before the war, and even the so-called swadeshi movement for the support of the indigenous industries died away in a comparatively short time. Thus, at the outbreak of the war, India's industries were few in number, and consisted of textile factories for the working up of a part of the home-grown supplies of cotton and jute, and to a less extent, of wool and silk; railway workshops, collieries, and a few engineering works at the chief ports, obtaining all their supplies of steel from other countries; a small number of flour and paper mills; a few tanneries producing chiefly half-tanned leather for export; some rice and oil mills. Pig iron was being produced in fairly large quantities by the Bengal Iron and Steel Company for some years before, but its efforts to manufacture steel had been unsuccessful; while the Tata Iron and Steel Company had commenced operations only in 1912, and was contending with numerous difficulties. Moreover a large proportion of these factories, with the notable exception of the cotton factories, were owned and managed by non-Indians, Indians mostly occupying the lower ranks of employees. A detailed examination of the causes of the small success of the industrial movement is not possible here. For the purpose of these pages, it is sufficient to

state that it was mainly due to the lack of the necessary technical knowledge and business experience on the part of Indians, to the want of sufficient capital and skilled labour, and to the pursuance of a strictly laissez faire policy on the part of the Government, which not merely declined to give any direct assistance to Indian industries, but which also purchased in England almost the whole of the stores required by its various departments. Thus, before the war India was entirely dependent upon other countries, especially the United Kingdom and Germany, for most of the manufactured goods essential for a civilised life.

During the war India's industrial position underwent a remarkable change. To-day, there is a considerable industrial activity in the country, which stands at the commencement of an era of a considerable industrial expansion, during which she will gradually occupy her rightful position as one of the important manufacturing countries in the world. This development is the direct result of the war, which clearly exemplified the grave dangers of dependence upon other countries for essential manufactures. During the war, India's supplies of manufactures from the Central Powers were entirely cut off, and those from the United Kingdom were considerably reduced on account of its concentration upon the prosecution of the war and the shortage of tonnage. Consequently, considerable hardships were experienced

by the people, who were largely dependent upon these imports. Moreover, when the war broke out, it was found that almost every industry in the country was entirely dependent upon foreign supplies not only for its machinery and plant, but also for the stores required for its daily working. These causes reinforced those, which stimulated the industrial movement before the war. The movement was further stimulated by the protection afforded to it by the reduction in the import of manufactures. However, India could not fully utilise the unprecedented industrial opportunities afforded by the war, because, in addition to the difficulties mentioned above, she had to contend with new difficulties arising directly or indirectly from the war, such as the great difficulty of obtaining the essential machinery and stores from abroad, which could not be made in India, the shortage of coal and coking plant coupled with a shortage of railway waggons and coasting vessels, and the difficulty of obtaining from abroad chemical and technical experts, who were needed in their own countries. The result was that, as seen above, a large part of the Indian market lost by the Central Powes and abandoned by the United Kingdom, was secured by Japan and the U. S. A., instead of being retained by India. Still the industrial advance achieved by India during the war was not inconsiderable. As regards the cotton industry, it may not be generally known that during the war all the military requirements of cotton textiles in the East were supplied by the Indian mills. There was a slight decrease

in the production of Indian yarns during the war, and this was accompanied by a considerable diminution in their exports. Hence, larger quantities were available for the home market, and the production of cloth by the mills increased by 20 per cent. The mills were able to increase their output only to the extent of their loom power, which could not be increased substantially on account of the great difficulties in the way of importing machinery. Moreover, there was a most marked tendency towards a decrease in the spinning of the coarser counts of yarn, and an increase in that of the finer counts. This tendency may be expected to continue, especially as the production of long-stapled cotton of American varieties is steadily increasing in India, and as, in addition, India is likely to obtain before long considerable quantities of long-stapled cotton from Uganda. Further, the war has left the mills in a strong financial position, large extensions have been planned, and are being carried out. Some mills have already employed highly trained chemists, and are developing their bleaching and dyeing processes in a very scientific way. A beginning has also been made in the manufacture of textile machinery and mill stores in India. In addition, large orders have been placed in the United Kingdom for textile machinery since the cessation of hostilities.

The jute industry enjoyed a continuous and unprecedented prosperity during the war, and underwent a

substantial expansion owing to the large demands on the part of the Allies for gunny bags and cloth for military purposes. Labour was plentiful, and while the price of gunnies rose steadily, the mills were in the fortunate position of being able still to command unlimited quantities of cheap jute except in the last year of the war. The expansion of the industry is shown by the following figures :—

Year.	No. of Mills at work	Capital in £ million	Numbers (in thousands) of Employees	Looms	Spindles
1913-14 ..	64	8.7	216.3	36.0	744.3
1918-19 ..	76	9.7	270.0	39.3	823.7

However, it may be remembered that the jute factories are still owned largely by the British, although the number of Indian shareholders has increased considerably in recent years.

The development of the iron and steel industry during the war was remarkable. While the Tata Iron and Steel Company was struggling with considerable difficulties in the production of steel in 1914, by the end of the war, its production of steel reached the figure of 17,000 tons per month, and the rolling mills produced 120,000 tons of rails and smaller sections yearly. The Government of India had agreed before the war to take 20,000 tons of steel rails annually for 10 years, provided that they could be produced of a suitable quality and at a suitable price ; but it took much larger quantities on account of the heavy

demands for war purposes. The rails were subjected to standard tests and proved to be quite satisfactory. The Company's production of pig iron increased to nearly 200,000 tons annually by 1918. Thus, the position of the Company has been revolutionized by the war. Having rendered the most valuable assistance to the Government in the prosecution of the war, the greatly enlarged and more efficient plant is now being devoted to supplying the industrial needs of the country. Further great extensions are in progress, and when completed, will revolutionize the engineering industry in the country, and the production of steel plates, sheets and wire for the first time in India will give a great stimulus to the shipbuilding, engineering and constructional steel industries. The most notable extension is the new electric furnace for the production of high-speed steel, which will enable the manufacture of machine tools and high-grade steel goods of all kinds. Furthermore, arrangements have been concluded for the establishment of a number of manufacturing companies round the steel works at Jamshedpur for the working up of the iron, steel and the by-products produced there into different kinds of manufactures. The works of the Bengal Iron and Steel Company at Kulti were also extended and remodelled during the war, and their monthly output of pig iron increased to 10,000 tons. The Company has now arranged for the production of steel in association with a well-known British concern. The war has brought about other important developments also in this industry. The

Indian Iron and Steel Company was floated in 1918 by Messrs. Burn & Co. of Calcutta, for producing pig iron and the usual by-products at Asansol, on the Bengal coalfields. A complete modern plant was purchased and erected, and is now in working order. For the present, pig iron and castings only are manufactured, but it is probable that later the manufacture of steel will be taken up. Messrs. Bird & Co., another well-known Calcutta firm, have also been developing large schemes of iron and steel production in combination with a large British concern. Moreover, a very large mountain range of high-grade iron ore rising to heights of 2,000 to 3,000 feet above the sea-level and extending over forty miles, has been discovered in Singhbhum in Orissa, and has been largely staked out by the Tata, Bengal and Indian Iron and Steel Companies and by Messrs. Bird & Co. This discovery may prove to be epoch-making in the history of the Indian iron and steel industry by providing reserves of high-grade iron ore sufficient for the iron and steel requirements not only of India but also of the surrounding Eastern markets in the near future.

Important developments have taken place in the leather industry also. Before the war, although India possessed a very large supply of tanning materials, both vegetable and chemical, the quantity of hides and skins tanned in the country was small, and most of the hides and skins were exported in a raw state chiefly to the Central

European Powers. This market vanished with the outbreak of the war, and India was left with a large supply of raw hides and skins. However, the demands on the part of the Allied armies for leather became very large, and the loss of the Central European market made the development of the tanning industry in India an urgent practical necessity, with the result that there was a great increase in the production of rough tanned hides, known as the East India tanned kips, in the Madras and Bombay tanneries, the whole of which was purchased by the Indian Government on behalf of the Home Government. The following figures of export show the remarkable increase in this trade since the war.

EXPORTS OF TANNED HIDES FROM INDIA.

Year.	Quantity shipped. Cwt. in thousands.	Value. £ million
1912-13	194.7	1.2
1913-14	187.7	1.3
1914-15	217.0	1.6
1915-16	272.0	2.0
1916-17	323.7	3.0
1917-18	365.1	3.3
1918-19	309.1	4.7

Table 9.

Before the war there were practically no expert tanners in the country, with the possible exception of Cawnpore, but this is now changed, and a number of large

firms have erected modern tanneries, and have secured the services of experienced English tanners. As regards leather manufactures, the Indian tanneries produced during the war greatly increased quantities of leather accoutrements of all sorts and of boots for the army in India and the Indian Expeditionary Forces. The stimulus given to this industry by these large Government purchases may be seen from the fact that the number of the pairs of boots and shoes manufactured annually was at the close of the war twenty times the pre-war figure. The output of harness and saddlery in the Cawnpore factories controlled by the Government during the war also increased considerably. A serious attempt is now being made to undertake boot manufacture permanently on a large scale. A number of firms have taken up the matter actively, and are importing the most modern machinery, and are engaging the services of experts.

Similar developments took place during the war in a number of other industries such as the engineering industries, the manufacture of chemicals, mineral acids, oils, paper, glass, soap, cement, cutlery, fertilisers, paints and varnishes, surgical instruments, but the limits of these pages do not allow a detailed description of their developments.

The development of Indian industries during the war was largely due to the stimulus afforded by the wide activities and the large purchases of the Indian Munitions Board.

This Board was created at the beginning of 1917 as a Department of the Government of India, consisted of a president and four members, and was supplemented by provincial organisations in each province. The Department was divided into a number of well defined branches relating to different trades and industries under expert Controllers. The functions of the Board as laid down in the Gazette of India in February 1917 were :—" to control and develop Indian resources, with special reference to the needs created by the war, to limit and co-ordinate demands for articles not manufactured or produced in India, and to apply the manufacturing resources of India to war purposes with the special object of reducing demands on shipping". The primary object of the Board was therefore the immediate supply of the requirements of the Allied armies in the eastern theatres of war, and not the development of Indian industries, but, in endeavouring to promote the activities of the Allied armies in the East, it also promoted the development of Indian industries in several ways, such as the direct purchase in India of all the articles required by the army, the civil departments, and the railways; the diversion, wherever possible, by means of its priority system and control of the home indents, of all the orders of private importers for articles from the United Kingdom and other countries, to manufacturers in India; the grant of assistance to individuals or firms in India, who wished to import plant or machinery, and to engage the services of technical experts and skilled labour

from the United Kingdom and other countries, in order to establish new industries or to expand the existing ones; and the collection and dissemination of indusrial information through an Intelligence Branch, and the grant of other direct or indirect assistance to individuals or firms prepared to estasblish new industries in the country.

With the exception of food-stuffs and certain technical stores, for the purchase of which special organisations already existed, the Indian Munitions Board undertook the supply of all the articles required by the armies maintained in and based on India, by the Government departments and by the railways, and also of certain articles required by the Home Government. Although many of the articles purchased by the Board in India were imported, it pursued the policy of depending more and more upon local manufacturers. Although a substantial part of its latter purchases was made from European manufacturing firms and joint-stock companies in India, the larger part was made from Indian firms and companies, and so gave a considerable stimulus to the promotion of Indian industrial enterprise. The same effect was produced by its priority system. With the object of saving tonnage and preventing unnecessary demands on the manufacturing resources of the United Kingdom and the U. S. A., the Board recommended the grant of a priority to the requirements of importers, only when the articles in question or suitable substitutes could

not be purchased locally, or their manufacture within a reasonable time could not be arranged. The opportunities arising in this manner were brought to the notice of firms likely to make use of them, and so, many new industries were started in India. The large list of articles for which the Board declined to recommend a priority for the reason that they or suitable substitutes could be manufactured in the country, shows the opportunities granted by the war to Indian manufacturers. Moreover, in many cases, the Board brought the names of manufacturers existing at the time to the knowledge of customers, who had not been aware of therir existence before.

Other activities of the Board also tended to promote the industrial development in India. The Board directed considerable attention to the development of the chemical industries, on the existence of which the sound development of industries depends to a very large extent. It maintained a permanent chemical adviser, conducted a number of researches through chemists, and gave all possible assistance to firms engaged in a similar work. It also gave much attention to the development of 'key' industries such as the manufacture of the accessories required by the milling, engineering, glass and tea industries. The *raison d'etre* of the Board ceased with the conclusion of the war. However, the duty of encouraging and assisting the growth of indigenous industries could not be abandoned by the Government, and therefore the place of the Indian Munitions Board has now been permanently taken up by the

Imperial Board of Industries and Munitions, in accordance with the recommendations of the Indian Industrial Commission.

The appointment of this Commission in May 1916 was another important outcome of the war. As explained above, the war clearly showed the urgent necessity of an industrial development in India, and the popular demand for active state assistance to achieve this object became more insistent than ever. Hence, the Government of India appointed the Commission to examine and report upon the possibilities of further industrial developments in India, and of a direct state encouragement to them. It was unfortunate that the tariff question was expressly excluded from the terms of reference to the Commission on the ground that the question was one of Imperial significance, and could be decided by the Government of India, only after the end of the war, and in collaboration with the other parts of the Empire in an Imperial Conference. The exclusion of this all-important question materially vitiated the value of the enquiry conducted by the Commission, and of its report. Nevertheless, the report and the recommendations contained therein possess very great value.

The Commission found that India produced nearly all the raw materials necessary for the requirments of a modern community, and therefore was rich in industrial

possibilities, but that her actual accomplishments in manufactures were very poor, and that she was unable to manufacture many of the articles and materials essential alike in times of peace and war. This was due to deficiencies in her industrial system, so great as to render her subject to foreign penetration in the time of peace and to serious dangers in the time of war. Her labour was inefficient on account of the absence of education, the prevailing low standard of life, and the effects of preventible diseases; she depended almost wholly upon foreign countries for the skilled labour of foremen and supervisors; her educated classes had not developed a right tradition of industrialism, a spirit of enterprise, and a sound system of technical training; and her stores of money lay inert and idle. The necessity of securing the economic safety of the country by developing the manufacture of commodities essential for a civilised life, and the inability of the people to secure it without the active encouragement and assistance of the Government, imposed upon the Government the duty of taking an energetic part in future in the industrial development of the country. However, it was impossible for it to perform this duty adequately, unless provided with an efficient administrative machinery, and equipped with reliable scientific and technical advice.

To achieve this object, the Commission recommended the creation of imperial and provincial departments of industries and of an Imperial Industrial Service. The

Imperial Department should be in the charge of a member of the Viceroy's Executive Council, assisted by a board of three members to be called the Indian Industries Board, and should be responsible for the industrial policy of the Government, and the working out of a well-conceived programme of industrial development throughout the country. The actual administrative work should be decentralised, and left to the provincial governments. For the efficient performance of this work, and to protect the Government from the difficulties of a casual recruiting, the Commission recommended the creation of an Indian Industrial Service consisting mainly of mechanical engineers and engineering technologists, the majority of whom would be employed under the provincial governments. The provincial departments of industries should be administered by directors, with the assistance of technical experts belonging to the imperial services, and with the advice of a Provincial Board of Industries consisting mainly of non-officials. Further, the Commission recommended the formation of an Imperial Department of Stores in India under a Controller-General, together with a stores branch in each provincial department of industries. All the indents for Government stores should be examined by this organisation, which should invite tenders and place contracts locally for such articles as can be manufactured in the country at competitive qualities and prices. The remaining tenders should be sent to the Stores Department of the India Office for being placed in the usual way.

These recommendations were accepted by the Government and are being gradually carried out. The more specific and detailed recommendations of the Stores Purchase Committee in the latter part of 1920 have been also accepted. The Stores Department in London has been placed under the control of the High Commissioner of the Government of India, so that the department has been transferred from the control of the Secretary of State to that of the Government of India.

So far, the industrial development that took place in India during the war and the causes which promoted it have been examined. The great question now is, whether this development will endure, or whether it will receive a set-back, as the economic conditions in the world gradually regain their regularity, and as foreign competition resumes its full sway. It must be admitted that the stimulus to the industrial progress given by the Indian Munitions Board during the war was largely artificial. The powers placed during the war in its hands under the Defence of India rules, gave it control over raw materials, and enabled it to prohibit their export, if necessary. The manipulation of the home indent and priority organisation enabled it to prohibit, by declining to recommend the grant of a priority certificate, the import of goods, which it wished to have made in the country, and consequently to eliminate competition. During the war, it was essential that everything possible should be made in India irrespective of its price, and goods were frequently purchased by the

Government in India at rates far above those at which they could have been imported, only if priority certificates had been granted. Moreover, the quality and finish of many of these articles were poorer than those of the goods formerly imported from the United Kingdom and elsewhere. Again, the control of coal, the control over the transit of goods by the railways, and the advantages secured by the firms engaged on Government work over their competitors, by obtaining priority certificates for the import not only of the renewals and repairs to plant, but also of new machinery, were all important factors, which enabled many firms to meet the rquirements of the Government on terms, which would not be acceptable under normal trade conditions. With the end of the war, this artificial stimulus to industries has had to be gradually abandoned. In addition, the raising of the exchange value of the rupee is materially, although temporarily, handicapping Indian industries by encouraging imports. Theoretically, it is true that the costs of production would be adjusted to the level of the prices and the exchange value of the monetary standards in competing countries, and that it is the comparative costs of production, which give rise to trade and determine competition. But it will be seen later that the process of the adjustment will be particularly difficult, and will take a comparatively long time, in the economic conditions of India, and that in the meanwhile the raising of the exchange will have the effect of handicapping the industrial development in India. Evidence is

forthcoming even from those British manufacturers who are profiting from this raising of the exchange, to prove that this effect is being felt by Indian industries. Here, it may only be mentioned, as a typical instance, that the United Kingdom's Senior Trade Commissioner in India, in his report on the conditions and prospects of British trade in India, not merely admits that the raising of the exchange has stimulated the import of manufactures into India, but also warns those British manufacturers, who may wish to establish works in India, that they must be prepared to face this handicap upon their enterprises in India. If all these factors are taken into consideration, it appears that, as the economic conditions in the Western manufacturing countries settle down, and as their industrial activities regain their normal proportions, and as the shipping situation becomes normal, some of the industries, which were started in India under the artificial protection caused by the war, will succumb under the stress of the oversea competition, unless they are placed on a sound and competitive footing by means of well-conceived, energetic and consistent efforts on the part of the industrial community with the guidance and assistance of the Government, to remove those industrial deficiencies, upon which the Indian Industrial Commission laid so much stress. If the industrial community and the Government co-operate harmoniously in this matter, the industrial advance made by India during the war will not only be maintained, but will also be further promoted. It is not possible within the

limit of these pages to examine the deficiencies in particular industries and to suggest means for their removal. Only the general deficiencies in India's industrial progress can be examined here.

First, as to the availability of capital. One of the most encouraging features since the cessation of the hostilities has been the readiness of Indian capital to subscribe to new industrial ventures, provided that confidence is felt in the names of their promoters and managing agents. The termination of the hostilities was followed by a considerable industrial boom in India. Licenses for new companies were freely granted, as the necessity of conserving the money market for Government loans had passed away. Most of the floatations by those promoters, in whom general confidence was felt, were over-subscribed, and the shares quickly advanced to a substantial premium. During the nine months April to December 1919, 634 new companies with an aggregate authorised capital of more than £134 million were registered in British India and Mysore, whereas during the corresponding period of 1918 the number of companies registered was only 158 with a capital of £4½ million. During the year 1919-20, 906 companies were floated with an aggregate capital of £ 183 million.* The most significant feature of these floatations was the large increase in their authorised capital. This was the result of the decrease in the purchasing power of the rupee, the

* Statement exhibiting the moral and material Progress of Indian in 1919, p. 78.

ease with which new capital was obtained, and the realisation that many of the older companies were under-capitalised, and had to depend substantially upon loans from banks and deposits, and to build up their finances out of profits This increase in the capital will promote stability, for credits and deposits are apt to fail when most required. However, a company cannot hang a heavier mill-stone round its neck than a paid-up capital in excess of its real requirements, and this is the danger lurking in these big capitals. One of the ablest financial authorities in London declared recently that not more than one-half of the profits of an industrial undertaking could be divided in practice, and when the huge amount of the capital of some of the new companies floated in India is taken into consideration, the difficulty of earning profits large enough to pay satisfactory dividends, becomes apparent. Further, the industrial boom was not quite healthy in all respects, because a considerable speculation lay at its bottom. This, however, is inevitable in any boom, and as the speculation was soon brought under some control, this boom spent itself gradually, and was followed by a slump, without causing any financial crisis. A boom is almost always followed by a slump, and unless the former has been unscrupulously engineered, and the public unduly foolish, the latter is a healthy process. The Indian public, on the whole, has been slow in giving its support to doubtful enterprises, and a large number of the companies are perfectly sound.

The financial difficulties of the large promoters have thus diminished substantially since the war. But the similar difficulties of the middle class industrialists are as great now as they were before the war. Their abilities are unknown to the public, which declines to give them financial support. The banks cannot lock up their money in buildings or machinery, while financial houses are scarcely to be found outside the Presidency towns, and even there, these industrialists are unable to offer to the financial houses, the security of approved names or of stock, which could be readily realised. So that, even now, they are dependent upon what they can collect from their friends and acquaintances, and, if this resource proves insufficient, they have to abandon their projects. To meet such cases, the Industrial Commission recommended the establishment of industrial banks with state assistance, which would keep themselves in touch with the middle-class industrialists,be able to estimate the prospects of a fairly large range of industries, and possess funds, which they could afford to lock up for a time in securities not easily realisable. It may be noted that the war has stimulated the formation of such banks, in spite of the absence of any state assistance, and four industrial banks, with large capitals, *viz.* the Gwalior Financial Corporation, and the Tata, Karnani and Calcutta, Industrial Banks are in existence now. If these succeed, others will follow, and the financial needs of the middle-class entrepreneurs will be largely provided for. As, however, the adequate extension of industrial

banks would require a considerable time, the Commission proposed that the Government should assist the existing banks in providing working capital to the middle-class industrialists. The provincial Director of Industries, with the assistance of his technical staff and a committee of business men, should examine the financial position and reputation and the methods of manufacture of applicants for financial help, and should certify those persons, whose position was found to be satisfactory, as deserving loans of particular amounts and for definite periods, from the banks participating in the scheme, the Government guaranteeing the sums lent, together with interest at rates agreed on with the banks. This proposal is admirably conceived, but its success in practice would depend upon the qualifications of the Director, and on the efficiency of the organisation created to examine the suitability of applicants for financial assistance.

The Commission also recognised that there would be some large industrial undertakings which could not be assisted by the public or the banks, and which would need direct Government assistance. If the undertakings are such as would supply an existing deficiency in the interests of the national safety or possess an important bearing on the economic development of the country, and if the prospects of their success are promising, the Government should render them a direct financial assistance in the shape of guarantees of dividends, or of

loans of money, or of undertakings to purchase a part of the output, for a limited period, as might appear desirable in each case. Where any kind of Government financial assistance was given, the Commission considered it desirable that the Government supervision should take the form of an audit, inspection and representation on the board of directors.

Assuming that the difficulty of the supply of capital has been met, the employers have next to consider the supply of labour. It is most remarkable that in a country with a population of 315 millions, whose standard of living is extremely low, a dearth of labour, especially for new undertakings, should exist, and that employers should be obliged to compete for labour of all kinds, and particularly for semi-skilled and skilled labour. Moreover, Indian industrial labour is not merely scarce, but is also intermittent. These difficulties are largely due to the fact that the Indian workman is primarily an agriculturist, and accepts industrial employment ony for a time, so that he may obtain a certain amount of money to reduce his indebtedness to the money-lender, or to supplement his small agricultural income, or to carry out some social ceremony. He returns to his village at the harvest time, and also whenever he has saved sufficient money to take a holiday. Consequently, India has no operative class depending entirely on its industrial labour for its livelihood. Further, Indian labour is in many cases, in spite of its low wages,

less economical than Western labour, and besides the quality of the work is often poor. India, therefore, far from gaining an advantage from low wages, is handicapped by the low efficiency of her labour. But the greatest difficulty arises from the fact that the Indian worker has a certain wage in his mind, just sufficient to give him and his family the barest necessaries of life, and that when this wage has been obtained, he has no ambition to earn more by working harder, in order to improve his condition. Hence, if the competition of employers leads to an increase in the current rate of wages, a common result is, as shown by the attendance-sheet of any mill or works, to produce a still further shortage, since a workman, who can support himself and his family for a week on four days' wages, will work for four days only, absent himself from the works for the balance of the week and spend it in idleness. Thus, of all the problems facing the industrialist in India, labour is probably the most serious, and also the most difficult to solve.

Serious attention has been paid to this problem since the war by Indian industrialists, and the Industrial Commission did the same. Its solution lies in raising the standard of comfort of the worker and his outlook on life. Free and compulsory primary education is the first essential for raising the efficiency of Indian labour. Better housing is equally necessary to secure a better time and attendance, and to create a permanent industrial class of workers. The

present housing conditions of labour in cities is, to say the least, deplorable. Again, efforts should be made to free the workers from the clutches of the money-lenders, and to encourage habits of thrift and a sense of self-respect. There is also an unlimited field for the development of welfare work of various kinds, such as the provision of adequate medical help, healthy recreation, libraries, social clubs and co-operative stores. It is noteworthy that the Tata Company has made an extensive provision at Jamshedpur for the comfort and welfare of its labour force. Indian industrialists should realise that these measures not only involve a social duty, but also that they are essential for the success of their enterprises, by helping them to keep a regular supply of labour, to improve its efficiency, to raise a new generation of workers attached to the works, and to train a sufficient number of skilled operatives. It goes without saying that these efforts of the industrialists must be adequately supported by the Government, especially in the matters of the education and the housing of labour.

So far the case of unskilled or semi-skilled labour has been considered. As one ascends the scale, the difficulties increase. Technical training is still inadequate, and the supply of skilled mechanics and men of similar grades is insufficient for any large development of industries. Competent managers of departments and foremen are even more difficult to

obtain ; and the great difficulties of effecting a satisfactory devolution of responsibility impose an additional strain on the persons in supreme control. The Industrial Commission examined this problem also very carefully, and made several valuable suggestions. For the training of artisans, it made definite suggestions for improving the system of apprenticeship in workshops and engineering establishments, such as a more liberal treatment in respect of wages, the provision of better opportunities for technical training, and the institution of a better form of agreement. The Government, through its departments of industries, should assist the works in the provision of an adequate technical education. The main object should be to counteract the tendency among the promising youths of the working classes to seek clerical occupations. This object would be promoted also by an improvement in the social status and the prospects of skilled artisans. With regard to the training of foremen, the Commission found that the opportunities in railway workshops were extensive, but that they were confined to Europeans and Anglo-Indians, and that there was a noteworthy absence of any provision for middle-class Indians. To rectify this deficiency, the Commission recommended that adequate arrangements for the training of Indian apprentices should be made, that they should be given respectable stipends during the period of training, that the conditions of training should be such as educated young Indians would deem consistent with their sense of self-respect, and that the

Government should share with the railway workshops the expenses of the provision of adequate training facilities, hostel accommodation, and such other amenities as might be necessary to attract educated youths of the middle class.

To these deficiencies in India's industrial equipment must be added the absence of a class of entrepreneurs for managing and directing industrial concerns. The population of India has been organised on the basis of a hereditary specialisation, the son following the occupation of his father. While this organisation has secured an excessive number of recruits for old occupations, such as the liberal professions and commerce in the strict sense of the word, it has obstructed the development of a class of entrepreneurs depending upon the direction of organised industry for their means of income. This tendency would have been largely corrected, if in the past the Government had made an adequate provision for higher industrial education. However, in fact, it was strengthened by the Government policy of confining its attention mostly to the provision of mere liberal education. The result has been to throw the opportunities for the industrial development in India largely into the hands of non-Indians. A characteristic feature of organised industry and commerce in nearly all the Indian centres has been the direction and control by large firms of managing agents, which, except in Bombay, are mainly non-Indian. Besides carrying on the export and import trade, they have financed and managed industrial

enterprises all over the country, and have many branches in the important towns. Their importance may be realised from the fact that they control the majority of jute, leather, paper, flour, and rice mills as well as tea-gardens, and coal, petroleum and gold mines. Since the war, the activities of the European firms of managing agents have increased, and, in addition, Japanese and American firms have appeared in the field. It is characteristic that the most important developments in the iron and steel industry now taking place are in the hands of three large European firms. It seems that the industrial development in India along these lines cannot do as much good to the country as a truly indigenous development would do, since the profits of the managing agents and the non-Indian shareholders obtained from these industries leave the country, which benefits mainly to the extent that Indians obtain employment among the lower ranks of workmen, and secondarily to the extent that the shares of these enterprises are held by Indians. Moreover, the foreign exploitation of the definitely limited supply of raw materials in the mineral industries, incapable of being replaced, appears to be directly opposed to the interests of the country. The substantial Government assistance to the industrial development in India, that is being contemplated, will not benefit the country much, if it is mainly or even largely derived by foreign firms in India. Therefore, it should be the aim of the Government to grant its assistance mainly to truly indigenous

enterprise, to foster it, and to help in the creation of a class of entrepreneurs, by all the facilities that it can give. One way to do this would be to send really capable and educated young Indians abroad for a higher industrial training at Government expenses in larger numbers and to endeavour to secure better training facilities for them than has been done in the past. Another way would be to give freely the services of Government chemists, geologists and other experts to, and to carry out gratuitously industrial research for those Indian industrialists who may be prepared to engage in new undertakings. Again, when indigenous enterprise may not be forthcoming to engage in new industries, which would probably fall into the hands of foreign firms, and if the prospects of success appear to be good, the Government should start the new industries, carry them through the experimental stage, train a sufficient number of men, and hand them over to private enterprise, when the experiments have proved successful. Economists of the strictest English school may object to this suggestion, but the war has shown, at least in India, that the notoriety, which Governments gained for industrial inefficiency was largely unmerited. Moreover, in two conspicuous instances, a substantial success has already been achieved in State-pioneering in India. The aluminium industry in Madras, and dairy-farming on the Western large-scale methods in Northern India were established directly by the Government, proved very successful, and were handed over to Indian companies.

Finally, there is the question of a tariff sufficiently high to give a substantial protection to new industries. Protection has the support of almost every class in India; which has so far found a voice, and Indian public opinion demands that the refusal of the Home Government, while the war was in progress, even to regard the subject as open to discussion, should now be reconsidered, and that the question should be left to the decision of the Government of India. It is not possible within the limits of these pages to enter on an examination of the merits of the question. But, it may be stated that, while the ultimate results of a tariff would probably be less than its more ardent advocates claim, and that while it will impose an appreciable burden upon the consumer, the immediate effect may be to supply a considerable stimulus to industrial enterprise.

General Statement of the Revenue and Expenditure Charged to Revenue of the Government of India in £ million.

	Revised Estimate			Budget Estimate			Accounts		
	Imper.	Provin.	Total,	Imper.	Provin.	Total.	Imper.	Prov.	Total.
		1913-14			1914-15			1914-15	
Revenue	53.6	30.6	84.2	54.3	30.8	85.1	50.8	30.4	81.2
Expenditure..	52.3	31.4	83.7	53.0	34.0	87.0	52.5	32.6	85.1
Surplus+ .. .. or Deficit—	+1.3	—.8	+.5	+1.3	—3.2	—1.9	—1.7	—2.2	—3.9
		1914-15			1915-16			1915-16	
Revenue	49.9	30.2	80.1	49.6	30.7	80.3	53.3	31.1	84.4
Expenditure..	52.7	32.4	85.1	52.4	31.8	84.2	54.5	30.9	85.4
Surplus+ .. .. or deficit—	—2.8	—2.2	—5.0	—2.8	—1.1	—3.9	—1.2	+.2	—1.0
		1915-16			1916-17			1916-17	
Revenue	52.0	30.6	82.6	55.7	30.5	86.2	65.7	32.4	98.1
Expenditure..	54.0	31.3	85.3	54.6	30.9	85.5	58.2	30.0	88.2
Surplus+ .. .. or Deficit—	—2.0	—.7	—2.7	+1.1	—.4	+.7	+7.5	+2.4	+9.9
		1916-17			1917-18			1917-18	
Revenue	64.9	31.9	96.8	66.6	32.3	98.9	79.1	33.5	112.6
Expenditure..	59.1	30.4	89.5	66.4	32.4	98.8	71.0	31.5	102.5
Surplus+ .. .. or Deficit—	+5.8	+1.5	+7.3	+.2	—.1	+.1	+8.1	+2.0	+10.1
		1917-18			1918-19			1918-19	
Revenue	76.7	33.7	110.4	74.0	34.3	108.3	86.9	36.3	123.2
Expenditure	70.9	31.4	102.4	71.7	34.4	106.1	90.7	35.2	125.9
Surplus + ... or Deficit—	+5.8	+2.2	+8.0	+2.3	—.1	+2.2	—3.8	+1.1	—2.7
		1918-19			1919-20			1919-20	
Revenue	85.6	35.9	121.5	86.4	37.0	123.4	96.0	39.5	135.5
Expenditure..	89.9	34.9	124.8	85.5	37.2	122.7	106.1	39.5	145.6
Surplus+ .. .. or Deficit—	—4.3	+1.0	—3.3	+.9	—0.2	+.7	+10.1	0.0	—10.

Table 10.

General Statement of the Revenue and Expenditure charged to Revenue of the Government of India in India and in England in £ Million.

REVENUE	Budget 1914-15	Actual 1914-15	Revised 1914-15	Budget 1915-16	Actual 1915-16	Revised 1915-16	Budget 1913-17	Actual 1913-17	Revised 1916-17
Land Revenue	21.7	21.2	21.2	22.0	22.0	21.7	21.9	22.0	21.1
Opium	1.7	1.6	1.5	1.8	1.9	1.9	2.3	3.2	3.1
Salt	3.4	3.9	3.7	3.4	3.6	3.5	4.0	4.8	4.8
Stamps	5.4	5.1	5.0	5.1	5.4	5.4	5.5	5.8	5.8
Excise	9.1	8.9	8.8	8.8	8.6	8.5	8.5	9.2	9.1
Customs	7.2	6.3	6.3	5.9	5.9	5.7	7.7	8.7	8.7
Other Heads	5.3	5.1	5.1	5.1	5.3	5.2	6.1	7.4	7.0
Interest	1.4	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1
Post Office and Telegraph	3.7	3.6	3.5	3.6	3.9	3.8	3.9	4.2	4.2
Mint	0.2	.07	.06	.07	.1	.07	.07	.7	.6
Receipts by Civil Depts.	1.4	1.5	1.5	1.5	1.6	1.5	1.5	1.7	1.7
Miscellaneous	.7	.7	.8	.6	.7	.6	.6	.8	.8
Railways	17.3	15.8	15.3	15.0	18.0	17.3	16.7	21.3	21.8
Irrigation	4.6	4.7	4.7	4.8	4.8	4.8	4.8	5.1	5.0
Other Public Works	.2	.3	.3	.3	.3	.3	.3	.3	.3
Military Receipts	1.4	1.4	1.3	1.2	1.2	1.2	1.2	1.6	1.5
Total Revenue	85.0	81.1	80.2	80.3	84.4	82.6	86.2	98.1	96.8
Deficit	..	1.8	2.8	2.8	1.2	2.0	..	..	..
Total	85.0	82.9	83.0	83.1	85.6	84.6	86.2	98.1	96.8

REVENUE	Budget 1917-18	Actual 1917-18	Revised 1917-18	Budget 1918-19	Actual 1918-19	Revised 1918-19	Budget 1919-20	Actual 1919-20
Land Revenue	22.3	21.6	22.2	22.4	22.1	20.9	22.6	22.1
Opium	3.4	3.1	3.1	3.2	3.3	3.2	3.0	3.0
Salt	4.0	5.5	5.4	3.5	4.3	4.2	3.9	3.7
Stamps	6.0	5.7	5.7	5.9	6.0	5.9	6.1	7.2
Excise	9.3	10.2	10.0	10.4	11.6	11.5	12.1	12.7
Customs	9.4	11.0	11.1	10.7	12.1	12.6	13.3	14.9
Other Heads	8.5	10.2	3.9	3.9	4.3	4.1	4.6	5.0
Interest	2.1	2.2	2.2	3.5	3.8	4.0	3.7	4.4
Post Office and Telegraph	4.3	4.6	4.5	4.8	5.3	5.3	5.7	6.0
Income Tax			6.1	6.3	7.8	7.3	13.5	15.8
Mint	.1	.5	.5	.4	1.8	1.7	1.3	1.7
Receipts by Civil Depts.	1.7	1.9	1.9	1.9	2.1	2.1	1.9	2.2
Miscellaneous	.7	4.9	2.6	1.3	6.7	5.8	2.5	1.9
Railways	20.2	24.1	24.0	23.0	25.0	25.3	21.4	21.6
Irrigation	5.1	5.1	5.2	5.3	5.3	5.4	5.5	5.8
Other Public Works	.3	.3	.3	.3	.3	.3	.3	.4
Military Receipts	1.3	1.7	1.5	1.5	2.3	1.7	1.6	7.1
Total Revenue	98.8	112.7	110.4	108.3	123.3	121.5	123.2	135.5
Deficit	..	..	..	..	3.8	4.3	..	10.1
Total	98.8	112.7	110.4	108.3	127.1	125.8	123.2	145.6

Table 11.

EXPENDITURE.	Budget 1914-15	Actual 1914-15	Revised 1914-15	Budget 1915-16	Actual 1915-16	Revised 1915-16	Budget 1916-17	Actual 1916-17	Revised 1916-17
Direct Demands on the Revenues	9.3	8.9	9.0	9.5	9.5	9.4	9.4	9.3	9.5
Interest	1.6	1.2	1.5	1.5	1.2	1.1	1.0	1.2	.8
Posts & Telegraphs	3.3	3.3	3.3	3.3	3.1	3.2	3.5	3.4	3.5
Mint	.1	.1	.1	.1	.1	.1	.1	.1	.1
Salaries and Expenses	19.8	18.9	18.9	19.1	18.9	19.1	19.3	19.1	19.6
Miscellaneous	5.4	5.3	5.4	5.1	5.1	5.1	5.3	5.4	5.4
Famine Relief & Insurance ..	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Railways: Interest & Miscellaneous Charges	13.4	13.6	13.3	13.8	13.9	14.0	14.2	13.8	14.2
Irrigation	3.6	3.7	3.7	3.6	3.7	3.8	3.8	3.5	3.7
Other Public Works	7.4	7.2	7.0	5.8	5.4	5.5	4.7	4.6	4.7
Military Services	21.9	21.8	21.8	21.2	23.5	23.0	23.2	26.6	26.8
Total Expenditure, Imperial and Provincial	86.9	85.1	85.1	84.2	85.5	85.3	85.6	88.2	89.4
Add Provincial Surplus	..	..	..	..	.3	..	..	2.4	1.6
Deduct Provincial Balances ..	3.2	2.2	2.2	1.1	.2	.7	.4	..	..
Total Expenditure charged to Revenue	83.7	82.9	82.9	83.1	85.6	84.6	85.2	90.6	91.0
urplus	1.3	..	..	..	..	..	1.0	7.5	5.8
Total	85.0	82.9	82.9	83.1	85.6	84.6	86.2	98.1	96.8

EXPENDITURE.	Budget 1917-18	Actual 1917-18	Revised 1917-18	Budget 1918-19	Actual 1918-19	Revised 1918-19	Budget 1919-20	Actual 1919-20
Direct demands on the Revenues	10.0	9.8	9.9	10.4	11.8	11.7	11.3	12.2
Interest	6.8	7.3	7.8	7.8	8.1	7.7	7.8	8.9
Posts and Telegraphs	3.6	3.6	3.6	3.9	4.0	4.1	4.6	4.7
Mint	.1	.2	.2	.2	.3	.3	.3	.3
Salaries and Expenses	20.9	20.8	20.9	23.0	23.7	24.5	24.3	25.8
Miscellaneous	5.6	5.9	5.9	5.6	6.3	6.1	6.1	6.5
Famine Relief & Insurance ..	1.0	1.0	1.0	1.0	1.0	1.0	1.5	1.2
Railways: Interest & Miscellaneous Charges	14.1	14.2	13.9	13.8	14.4	14.1	14.5	14.6
Irrigation	3.8	3.8	3.7	3.9	3.9	4.0	4.1	4.2
Other Public Works	5.5	5.0	5.1	5.9	5.6	5.6	6.8	6.9
Military Services	27.2	30.8	30.3	30.5	46.8	45.6	42.8	60.1
Total Expenditure, Imperial and Provincial	98.8	102.5	102.3	106.1	126.0	124.8	124.0	145.6
Add Provincial Surplus ..	.2	2.2	2.3	.3	1.1	1.2	..	.7
Deduct Provincial Balances	.3	.2	.1	.4	..	.1	1.6	.7
Total Expenditure charged to Revenue	98.7	104.6	104.6	106.0	127.1	125.8	122.3	145.6
Surplus	.1	8.1	5.8	2.3	..	..	.9	..
Total	98.7	112.7	110.4	108.3	127.1	125.8	123.2	145.6

Table 12.

CHAPTER IV.

The Revenues and Expenditure of the Central and Provincial Governments.

At the time of the outbreak of the war, the finances of the Government of India were on the whole in a satisfactory position, for, the south-west monsoon was favourable and promised agricultural prosperity, the loan operations of the Government had proved a great success, and their total treasury balances had been found to be larger than the estimate, which had originally been made at the time of the preparation of the budget. It is true that for some months before the war, trade had been somewhat depressed owing to the previous unfavourable agricultural season, and the after-effects of the bank failures of 1913-14. But at the time of the declaration of the war, the trade depression was beginning to give way to greater activity, there was every prospect of a good year owing to the favourable agricultural situation, and if normal times had continued, the budgeted imperial surplus would in all probability have been exceeded.

These prospects however were swept away by the war and, as table 10 shows, the budgeted surplus was turned into a large deficit. Table 11 shows that the decline of the revenues occurred under several heads. The decline

of the revenues from railways, customs and opium as compared with the budget estimate was due to the disturbance and depression of foreign trade that followed the outbreak of the war. In regard to the railways, it was found impossible to reduce the working expenses forthwith in proportion to the large and sudden decrease in the normal receipts, as much of the expenses were of a fixed character. The customs and opium revenues were affected by the fall in prices. The decrease in Interest receipts was mainly due to the depletion of the Secretary of State's balances in London, which, in ordinary times, would have earned interest till their final disposal. The fall in the receipts of Posts and Telegraphs was brought about by the reduction of business and interruptions of telegraphic communications entailed by the war. The adverse trade conditions also affected the Excise, Land and Stamps revenues, but in these cases the Central Government shared the loss with the Provincial Governments, these being divided heads of revenue. The only head of revenue under which the budget expectations were exceeded was Salt, but in this case the Finance Member expressed the opinion that the increase was deceptive, as it merely represented advance payments of duty to avoid a threatened increase of the salt duty. Thus the adverse effect of the outbreak of the war upon the revenues of the Central Government was considerable, and, consequently, the very optimistic view taken by the Viceroy in his speech in the Legislative Council closing the financial debate

in March 1915, that the war had convincingly brought out the inherent soundness and strength of India's financial position, does not appear to have been quite correct at that time, especially if the deficiencies of India's financial position revealed by her Ways and Means, and currency and exchange, difficulties, and the run upon postal savings banks and Paper Currency Offices, are taken into account.

The war however revealed that India's financial strength was considerably greater than many of her financial experts had thought, and that since 1908, when Indian finances suffered immensely during the world crisis of the year, it had increased more than they were prepared to admit. Speaking in the Viceroy's Legislative Council in 1909, the late Mr. Gokhale laid particular emphasis on the fact that never during the 50 years previous to that year had there been such a heavy deficit as that of £3.75 million in 1908-9. As the result of the unparallelled blow dealt by the war, most experts had expected a much heavier deficit for 1914-15, but to their surprise, it was £1 million less than that for 1908-9. India's financial strength becomes more evident, when it is explained that the revenues of the Central Government were in 1919-20 almost double those in 1913-14. A part of this increase was, no doubt, the result of the enhancement of taxation and the inflation of currency. But the larger part was the result of natural growth. Again, table 10 makes it clear that from 1915-16, the actual total revenues every year

far exceeded their budget estimate. This, however, appears to have been largely due to their under-estimation, at the time of framing the budgets.

While most of the heads of revenue expanded more or less, the immense increase in the total revenues within the period of six years, was largely due to the expansion in railway and customs receipts, and in the yield from taxes on incomes and profits. In proceeding to examine them, it may be pointed out that the budget estimate for each year should be examined in relation to the revised estimate for the previous year, framed one month before that year is over, for the Finance Member prepares the budget estimate each year, by considering how far the figures of the revised estimate for the previous year—the latest figures available at the time of framing the budget—are likely to be affected by conditions expected to prevail during the year, for which the budget estimate is prepared. The budget estimate of the net receipts from railways for 1915-16 was £ .8 million less than the revised estimate for the previous year, because the Finance Member had to provide for the adverse effects of the war, extending over the whole of 1915-16, as against 8 months of 1914-15. This consideration would have led to a much lower budget estimate of these receipts, had it not been counterbalanced to some extent by the Finance Member's expectations of an appreciable recovery of credit, confidence and trade, and by more favourable agricultural prospects. The actual

receipts for that year, however, amounted to £ .3 million more. The factors, which led to this increase and to still more remarkable increases in subsequent years, were:— (1) The diversion of a large amount of traffic, especially coal, to railway routes from the sea routes, on account of the shortage of coastal shipping resulting from the war. (2) The greater activity of internal trade on account of the diminution of imports, for instance, cotton piece-goods manufactured in Bombay, Ahmedabad and Nagpur, and carried by the railways to Bengal, making up to some extent, the diminution in the imports of piecegoods from Lancashire into Calcutta by sea. (3) The greater military activity, resulting in larger movements of troops and military stores on railways. The increase in railway receipts from this casue was illusory, and not a source of financial strength, as the Government of India paid a certain amount out of one pocket into another. (4) The larger exports of raw materials and partially and fully manufactured goods from the interior to the Allied countries for the prosecution of the war, as compared with the exports during 1914-15. The progress of the war rendered the operation of these factors more and more powerful. However, the budget estimate of the net receipts for 1916-17 was £ .6 million less than the revised estimate for 1915-16, because the Finance Member held that the prospect was not altogether encouraging on account of the deficiency of the south-west monsoon, and the possibilities of the war causing more stringent trade

restrictions. The actual net receipts surpassed the budget estimate by more than £ 4½ million, and the Finance Member attributed this surprising result to favourable rains, in addition to the factors mentioned above. In the budget for 1917-18, the net receipts were estimated at £ 1.2 million less than the revised estimate for the previous year, on the ground of the provision of an increased expenditure on renewals and working expenses rendered necessary to enable the railways to handle the unprecedented increase in traffic. But in the accounts for that year, the receipts amounted to £ .2 million more, and again broke the record created in the previous year, owing to the operation of the same causes as before.

In 1918-19, the net railway receipts were budgeted at a million £s less than the revised estimate for 1917-18, because the Finance Member thought that he had to allow for the operation of several adverse factors; in the first place, the extraordinary net receipts for 1917-18 had been augmented by a favourable monsoon, and it would have been unwise to count upon the continuance of the same conditions; secondly, the continued wear and tear of the rolling stock and permanent way for lack of renewal, had reached such an advanced stage that the Finance Member felt doubtful whether the railways would be able to cope with the demand made upon them for handling passenger and goods traffic; lastly this heavy wear and tear rendered it quite necessary that provision

should be made in the calculation of working expenses for renewal as far as circumstances allowed. These prognostications of the Finance Member were not realised at all. The railways continued to prove a source of financial strength, and he explained this away by stating merely that it had been found possible to subject the railway system to a still greater strain without a break-down. In the budget for 1919-20, the net railway receipts were estimated to bring in £ 4 million less than the revised estimate for 1918-19. It is true that the gross receipts were estimated to amount to £ 2·3 million more, as the reduction of military requirements was expected to be more than made up by increasing private demands for railway facilities. But from this figure, a very heavy deduction of £ 6½ million was made for special renewals after the forced neglect of the last few years. The Finance Member emphasised the urgency for drastic renewals, and explained that the railway authorities were confident of being able to spend this large sum profitably. The actual receipts exceeded the budget estimate by £ .2 million, in spite of the effects of the famine, and political disturbances, especially in the Panjab, which particularly affected the railway traffic.

The Customs revenue more than doubled by 1919-20 as compared with 1913-14. Only a part of this increase, however, was the result of the natural growth, while the remainder was due to the enhancement of existing duties

and the imposition of new ones. The outbreak of the war affected this head of revenue more than any other, and it continued to decline in 1915-16, while other heads recovered substantially their former position, in that year. This was due to the reduction in imports brought about by the growing shortage of tonnage. In the budget for 1916-17, the estimate of the receipts from the existing Customs duties was practically the same as in the revised estimate for 1915-16. There were, no doubt, possibilities of further trade restrictions, but their effect was expected to be neutralised by the rise in prices, which would have resulted in greater yield from ad valorem duties. However, in order to help in making up the expected deficit in total revenues, the general import tariff was raised from 5 to $7\frac{1}{2}$ per cent ad valorem, with a few exceptions, and an export duty on two important staples, tea and jute, was levied. These enhanced and new duties were estimated to yield a little over £ .2 million. The actual total Customs revenue amounted to nearly £ one million more than the budget estimate. This increase was due, to some extent, to more favourable trade conditions, but much more to the rise in pricee, which brought about an increase in the receipts from ad valorem duties. In the budget for 1917-18, the Customs revenue was estimated to decrease by £ .7 million on account of the adverse effect of the increasing shortage of tonnage on imports and exports, the former being further affected by the concen tration of the manufacturing countries of the West on the

production of war munitions, and the latter by exchange difficulties and special restrictions. But the actual revenue amounted to £ 1.6 million more than the budget estimate, and this was attributed by the Finance Member to the factor mentioned above, *viz.* the continuous rise in prices. In the budget for 1918-19, the Finance Member maintained that with the progress of the war, it became more and more difficult to anticipate the effect of the opposing factors mentioned above, on the customs revenue, that, on the one hand, the shortage of tonnage, and the restrictions on production in and exports from the United Kingdom were becoming progressively acute, and that, on the other, these adverse factors were considerably neutralised by increasing exports from Japan and the U. S. A., and by the rise in prices. Weighing these opposing forces, the Finance Member estimated the Customs revenue at £. 4 million less than the revised estimate for the preceding year. When the actual revenue amounted to nearly £ 1½ million more than the budget estimate, it was attributed to a more powerful operation of the favourable factor connected with the rise in prices. The budget estimate of the revenue for 1919-20 was £ 1.2 million higher, because the reduction in the proceeds of ad-valorem customs duties due to an anticipated fall in prices on the return of peace, was expected to be more than neutralised by an increase in the volume of imports to replenish exhausted stocks, rendered possible by somewhat easier tonnage situation. The actual revenue amounted

to £ 1.6 million more, partly because the Finance Member's anticipation of a fall in the level of prices was not at all realised, and all the more important tariff heads showed an increase, and partly because an export duty on hides was imposed in the middle of the year.

The yield from the taxes on incomes nearly trebled in the period of six years, with which these pages are concerned, if the excess profits duty levied for a single year in 1919-20 is taken into account, and more than doubled, even if that duty is not taken into consideration. The increase, however, was mainly the result of higher taxation, although, to some extent, it was due to higher profits secured in those trades and industries, which throve on account of war conditions, especially in capital cities. In 1916-17, in order to help in meeting the expected deficit in the total revenues of the Central Government, the rates of the ordinary income tax were raised, so as to bring in £ one million more. In 1917-18, a super tax was imposed on large incomes in addition to the graduated income tax, and was estimated to yield nearly £ $1\frac{1}{2}$ million, to enable the Government to meet the burden imposed by the gift of £ 100 million to the Home Government. In 1919-20, a duty on excess profits earned during 1918-19, was levied for a year, to assist the Government in meeting another burden resulting from a second financial gift to the Home Government. The yield from the duty was estimated at nearly £ $7\frac{1}{2}$ million.

Against this, however, a loss of the yield of the super tax and income tax amounting to £ 1½ million had to be provided for, since the super tax and excess profits duty were not to be both assessed on the same business, and a rebate was to be given for the purposes of income tax, on the amounts paid as excess profits duty. The duty was removed in 1920-21. Income tax has been a divided head of revenue, the yield being divided in certain fixed proportions among the Central and Provincial Governments. But the whole of the yield from the enhancement of the income tax and from the super tax and the excess profits duty was appropriated by the Central Government, because the taxes had been raised or levied solely in order to meet the increase in the expenditure of the Central Government brought about by war condtitions.

Other heads of revenue, contributing in a substantial measure, although in a less degree than the heads examined above, to the increase in the total revenues in our period, were interest, opium and excise. The interest receipts amounted to nearly £ 4½ million at the end of our period, as against a little more than £ one million at the beginning of it. The increase began in 1916-17, and continued to grow, but this improvement did not become prominent in the revenue account till 1917-18, because in 1916-17 the whole of the increase, and in 1917-18 a part of it, was set aside to form a Paper Currency Depreciation Fund, the necessity for which had arisen on account of the depreciation

in the value of the consols, in which a considerable portion of the Paper Currency Reserve had been invested. The expansion of the interest receipts was almost entirely the result of Government war finance. As will be explained fully in the next chapter, the Secretary of State obtained larger and larger funds from the Home Government in the form of the recovery of the disbursements made on its behalf by the Government in India, and from the sale of Council drafts, and he invested these funds in England, largely in the Home Treasury Bills.

The opium revenue was doubled during the period under examination, on account of the greater demand from the Far East, and also from England for medical purposes, the latter being the result of the closing of the Turkish market. This enabled the Government to increase the price at which opium chests were auctioned. The excise revenue increased nearly by £ 4 million, and this was attributed to stricter administration, and to more favourable trade and agricultural conditions. This increase, more and more marked from 1916-17, was satisfactory, so far as it was the result of the former cause, but was far from being so, so far as it indicated an increase in the consumption of liquor.

From 1917-18 the Government obtained a new but temporary source of revenue, *viz.* profits from exchange included under Miscellaneous. In August 1917 the

Secretary of State increased the rates for Council Bills and Immediate Telegraphic Transfers from 1s. $4\frac{5}{32}$ and 1s. $4\frac{1}{4}$d. to 1s. $4\frac{9}{32}$ and 1s. 5d., respectively. This rise in exchange resulted in a large gain, amounting to £3 million in 1917-18, in the remittance of Home Charges, and in the recovery of disbursements made by the Government on behalf of the Home Government. In 1918-19 the net profit was nearly £5 million. The budget estimate of the revenues and expenditure for 1918-19 was framed on the basis of the rate of 1s. 4d. to the rupee, and the sterling obligations were provided for at the same rate, although the rate prevailing at the time was 1s. 5d., because the exchange position was very unstable, and it was considered unsafe to act on the expectation of a continuation of the higher rate. However, as matters actually turned out, in April 1918 the rate had to be raised further to 1s. 6d., for the reasons explained in a later chapter, and this enabled the Government of India to make a large saving in rupees in meeting its sterling obligations at the rate of 1s. 6d. To this was added the gain in respect of recoverable war expenditure incurred in India on behalf of the Home Government, arising from the same cause. The gross profit from exchange was much larger than £5 million, but it was decided to deduct from it, the loss which the Government sustained on account of the coinage of rupees in large numbers, which were put into circulation at the old rate of 1s. 4d., but which cost the Government more to produce, *i. e.* in economic phraseology the legal

value of which was less than their intrinsic value. Although the gain from exchange was very large in 1919-20, it was entirely set aside for purposes of capital outlay on railways, irrigation, and the building of Delhi, and for meeting the deficiency in the Paper Currency Reserve. The gross gain from the progressive rise in exchange amounted to £ 15 million, but from it were deducted a loss of £ 3 million on rupee coinage, and another of £ 4.2 million due to the Secretary of State's purchases of gold at a premium, because the losses arose from the same causes that contributed to the higher exchange value of the rupee. However, even the net gain from exchange was regarded as artificial, and not a real accretion to the resources of the Government, so far as it arose from mere transfer of funds between India and England. For, although a gain from exchange accrued, every time that the Secretary of State sold Council Bills on the Government of India, and that expenditure was incurred in India on behalf of the Home Government and recovered in England, a loss resulted, whenever Reverse Councils or sterling money orders on London were sold. The only operations, the exchange gain in respect of which was regarded as real and permanent, were the purchases of machinery and stores abroad in connection with the capital outlay on railways, irrigation, and the building of Delhi. It was therefore regarded as necessary that these capital accounts should get the benefit of the higher rate of exchange. Then, there was another important consideration. The ultimate

abandonment of the 1s. 4d. rate for accounts purposes, and the adoption therefor of a 2s. rate, would result in a heavy capital loss on the sterling holdings of the Government of India, especially in the Paper Currency Reserve. The deficiency in the Paper Currency Reserve, assuming a revaluation of its sterling portion on the basis of the 2s. rate, was estimated at nearly £ 27 million, and the Finance Member strongly emphasised the importance of making up this deficiency, by setting aside each year a part of the gain from exchange, on the ground that a position, in which the sterling portion of the Reserve was clearly insufficient to cover that part of the note circulation against which it was being held, would shake public confidence, upon which the circulation primarily depended. For these reasons, it was decided to credit the railway, irrigation and Delhi capital accounts with £ 4.8 million out of the £ 7.8 million of the net gain on exchange during 1919-20, and to set aside the whole of the remainder for meeting the deficiency in the Paper Currency Reserve.

Proceeding to examine the growth of the expenditure of the Central Government during the period under consideration, table 10 shows that the expenditure also doubled. There was, however, a marked contrast between the expenditure of the first financial year of the war and of those that followed. The actual expenditure of the first year was less than the budgeted expenditure, while in the succeeding years the position was reversed, and the excess

of actual expenditure over its budget estimate increased with the progress of hostilities. This was due to the fact that during the first financial year, India did not recover from the impact of the war, and therefore was not in a position to contribute financially to its prosecution to the extent that it did in the succeeding years. Nor was India's financial help so urgently needed by Great Britain during the first year as in the following years, because the latter's financial resources began to be severly taxed only from the second year. During the first year, the urgent need of the Allies was for men and not so much for money, and, at this critical time India unstintingly poured forth her best blood on the battlefields of Flanders and France. In fact, it has been freely acknowledged by military experts that, but for India's Sikh, Jat and Gurkha battalions, England and France, unprepared as they were for war, would have found it well-nigh impossible to stem the onrushing tide of German armies. By the time Great Britain's financial resources began to be strained heavily, India had begun to recover from the effects of the outbreak of the war, and rendered increasing sacrifices, perhaps even more than her very limited financial resources really allowed, till the successful termination of hostilities.

The immense increase of the total expenditure was very largely the result of the continuous expansion of military expenditure, and was due, to a much less extent,

to the growth of the salaries and expenses of civil departments, interest payments and the direct demands on the revenues. The military expenditure nearly trebled in 1919-20 as compared with that in 1913-14. In 1914-15, although the estimates of the different classes of military expenditure were much disturbed by the war, the total expenditure departed but little from the budget owing to the counterbalancing action of several technical factors. In the budget of 1915-16 a reduction in the expenditure of a little more than £ ½ million was expected as compared with the revised estimate for the preceding year, or account of the postponement of all ordinary military expenditure not necessary immediately. But the actual expenditure amounted to £ 2.3 million more than the budget estimate, on account of the agreement with the Home Government that India should make no saving from war conditions. Thus, although the normal drafts and reliefs of troops had ceased, it was decided to pay their sea transport charges. Similarly, although the number of the Territorial troops was at first less than that of the Regulars whom they replaced in India, it was decided to pay the same amount as before.

The budget estimate of the military expenditure for 1916-17 was only £·2 million higher than the revised estimate for 1915-16, but the actual expenditure amounted to nearly £ 3½ million more, due to larger outlay on rifles and on strengthening the frontier position, to higher prices of

military stores, and to increased railway charges in respect of larger movements of troops and stores. In the budget for 1917-18, £ $\frac{1}{2}$ million more were provided for higher pay and pensions granted to the Indian army, and for a moderate reserve against unexpected contingencies. The actual expenditure, however, was £.$3\frac{1}{2}$ million more, on account of larger operations on the frontiers, larger movements of troops and stores, and higher prices of military stores. In the budget for 1918-19, £.2 million more were provided. The expenditure was really expected to be substantially smaller, because the increase under some items was estimated to be more than counterbalanced by the non-recurrence or decrease of other items. However, in view of the large increase of the total military expenditure over the budget estimate in the past two years, the Finance Member thought it necessary to provide a larger reserve than before, to meet unforeseen contingencies. But in the actual expenditure, there was a phenomenal increase, which amounted to nearly £ $16\frac{1}{2}$ million. Of this, £ 12.7 million was due to the special war contribution given by the Government of India. The initial success of the Germans in their 1918 spring offensive rendered the military position of the Allies very critical, and in response to the appeal of the Prime Minister, the Government of India undertook to raise and train additional 500,000 men, and to bear the charges in respect of 200,000 of these from 1st April 1918 and of 100,000 more from 1st April 1919. On account of the collapse of the enemy

in November 1918 and the armistice which followed, it became unnecessary to continue recruiting. But the recruitment already made, involved an additional expenditure of £ 12.7 million in 1918-19 in accordance with the above offer of the Government of India. The remainder of the increase in the military expenditure was due to larger military preparations on the north-west frontier in view of the fresh German menace through Central Asia, and the unforeseen operations against the Mari tribe, which had proved a source of considerable trouble.

In the budget for 1919-120, the ordinary military expenditure was estimated to amount to £ 32½ million as against the revised estimate of £ 31¼ million for 1918-19, because the economies in respect of the outlay on military works and expenditure on the frontiers, were estimated to be more than neutralised by the imperative demands of military efficiency in the light of the lessons taught by the war, such as improved armaments and equipment and more rapid transport. In addition to the ordinary military expenditure, £ 8.7 million had to be provided for the second instalment of the special war contribution mentioned before, as against the first instalment of £ 12.7 million in the previous year. Thus, although the total military expenditure for 1919-20 was estimated to be £ 2¾ million less than the revised estimate for the preceding year, the Finance Member admitted that it represented a figure considerably in excess of what he hoped would be

the normal military expenditure in future. In the actual expenditure, however, there was another phenomenal increase amounting to no less than £ 17·3 million. This was mainly the result of the Afghan war and the operations against Mahsud and Waziri tribes. The cost of all these operations reached the sum of £ 14¾ million. The Finance Member admitted that it might have been less, but maintained that the crisis arose at a time when the resources of India had been severely taxed by the world war, that high prices ruled everywhere, that a higher standard of efficiency in the military organisation had to be provided for, and that every measure had to be adopted, which economised human life at the expense of mechanical contrivances, and ensured greater comfort for the troops. Furthermore, the ordinary military expenditure exceeded the provision in the budget for it by £ 9.1 million. This increase was explained to be partly the result of residuary obligations arising out of the war, such as the war gratuity to British officers and soldiers serving in India during the war, the increase in their pay, the grant of six monthly bonuses to Indian troops and rewards in the shape of cash and land grants to Indian officers and men who had rendered distinguished services during the war, and partly the result of the influence of frontier operations involving the provision of mechanical transport, additions to animal transport, the increase of the air force establishment and additional military works. The increase in the total military expenditure would have been much higher,

if the second instalment of special war contribution amounting to £ 8.7 million, provided for in the budget, had been paid in full. The whole contribution, however, was subject to the condition that its payment might be reconsidered in the event of the occurrence of two contingencies, namely frontier operations involving large expenditure, and serious financial burdens resulting from a famine or a currency crisis. The first condition had become operative, and the Imperial Legislative Council passed a resolution to the effect that the sums payable for effective and non-effective charges under the resolution making the war contribution, may be paid to the Home Government after deducting therefrom the expenditure on the Afghan war and the operations against the frontier tribes, and including the charges mentioned in the financial statement and amounting to £ 1 million, which, if the full contribution had been paid, would have been taken against it. This resolution was accepted by the Government, and under its terms £ 1.8 million were paid to the Home Government.

Thus, India did not escape from the enormous growth in the military expenditure, which was one of the most unfavourable features of the war finance of the Western countries. In 1918-19 it consumed more than $\frac{1}{3}$ of the total revenues, and in 1919-20 far more. Even in the budget for 1920-21 the huge sum of £ $41\frac{1}{2}$ million has been provided for it, and the general hope that the termination of hostilities

would enable the country to secure financial resources required for social and economic development, by means of the curtailment of the military expenditure, has not been realised. Moreover, the military reorganisation propsed by the Esher Committee will involve heavy expenditure, and the addition of the burden of the maintenance of a navy appears to be probable. The military expenditure has been a subject of public criticism for over a generation. Indian politicians have maintained that India has been keeping an army beyond her requirements, which has been used from time to time in operations beyond her frontiers, and that India, as compared with the self-governing Dominions, has been bearing more than her legitimate share of the military burdens. It is not the function of an economist to examine the truth of such assertions, but it is his function to draw attention to the enormous economic waste involved in this huge military expenditure. Eminent economists such as Gide, Pigou and Cassel drew the attention of the International Financial Conference at Brussels 1920, to this problem in the Western countries, and if the continuance of the waste of economic resources is harmful to those countries, it is much more so in the case of India, whose resources relative to the demands of the population upon them, are more limited.

Another unfavourable feature of the expenditure has been the continuous increase in the cost

of the administration as the following figures show :—

Net Expenditure on the Salaries and Expenses of Civil Departments in £ million.

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19	1919-20
General Administration. ..	2·0	2·0	2·0	2·0	2·1	2.2	2·7
Law and Justice. Courts	2·7	2·9	2·9	2·9	2·9	3·0	3·2
Law and Justice. Jails.	0·7	0·7	0·7	0·7	0·7	0·9	1·2
Police	4·7	5·1	5·2	5·3	5·5	5·8	6·6
Ports & Pilotage.	0·05	0·1	0·1	0·1	0·1	0·1	0·2
Education ..	3·0	3·0	2·8	2·8	3·1	3·7	4·2
Ecclesiastical ..	0·1	0·1	0·1	0·1	0·1	0·1	0·1
Medical & Sanitation	1·2	1·4	1·4	1·3	1·5	1·5	2·0
Political	1·1	1·1	1·2	1·3	2·1	2·6	2·1
Agriculture ..	0·5	0·5	0·5	0·5	0 6	0·7	0·8
Scientific and Miscellaneous Departments..	0·4	0·4	0·3	0·2	0·2	0·3	0·5
Total ..	16·1	17·4	17·3	17·4	19·0	21·6	23·7

Table 13

Thus, in six years the net expenditure rose to half as much again. A part of the increase was inevitable owing to the rise in prices and the cost of living, but it does not follow that the continuance of the actual increase is unavoidable. It will be possible to effect an appreciable reduction under the several heads as a whole, excepting those of education, sanitation, medical relief and agriculture, by achieving economies wherever possible, and mainly by substituting cheaper but not less efficient Indian agency for the more costly English agency, wherever permissible, as laid down in the Constitutional Reforms.

A third head of expenditure exhibiting a very large increase is Interest, the payments of which increased from £ 1½ million in 1913-14 to nearly £ 9 million in 1919-20. This was chiefly due to the fact that the war contribution of £ 100 million entailed the annual charge of more than £ 6 million on account of interest and sinking fund provision. This increase was one of the inevitable results of the war sacrifices borne by India, and there is no prospect of its diminution in the near future, because it is improbable that after meeting the needs of expenditure, any substantial resources will be available for reducing the debt. The burden will have to be borne for some time as one of the legacies of the war.

Another important feature of the expenditure of the Government of India during the period under consideration, was the retardation of progress in education, sanitation and medical relief. It is impossible to draw an adequate picture, within the limits of these pages, of the backwardness of India in these matters. But as the fact is generally admitted, it will be sufficient merely to point out that at present 94 per cent of the population in India is illiterate as compared with 1.6 per cent in Scotland, 1.8 per cent in England and Wales, 7.7 per cent in the U. S. A. and 17.4 per cent in Ireland. In the matter of sanitation and medical relief, the annual reports of the Sanitary Commissioner of the Government of India bear witness to the large mortality resulting from the annual

visitations of plague and cholera, and the continuous prevalence of malaria. In addition, the serious loss of vitality resulting from malaria should be taken into account. But the best proof of the inadequacy of sanitary and medical arrangements was given by the influenza epidemic, which, according to official calculations, within three months, October-December of 1918, took a toll of nearly 6 million people, more severe than that exacted by the world war during the course of four years. The Sanitary Commissioner explained that the mortality was far more severe in rural areas than in towns. This was natural, because the deficiencies of sanitation and medical relief are far greater in the former. Now, these pages are concerned only with the economic loss, and not with the national or social loss, resulting from all these deficiencies, and the urgency of reforms in these matters must be considered from the same point of view. Here again, it is not possible to explain fully, the actual economic loss. But it is generally acknowledged that India's general poverty and low standard of living are largely the result of the inefficiency of her factory as well as agricultural labour, the crudity of her agricultural methods, and the deficiencies in the organisation of her industries, as compared with western standards, and that these economic evils, together with many others, such as the hoarding habit and the liability to a sudden panic, exposing the currency and banking systems to considerable dangers, are largely due to the prevalence of utter ignorance among the vast masses of the

population. The inadequacy of sanitary and medical organisations involves a considerable loss of human energy, complete or partial, and is partially responsible for other economic difficulties such as those connected with the organisation of permanent industrial labour in large cities. Thus it becomes evident that progress in education, sanitation and medical relief plays a vital part in India's economic advance.

From 1911-12 to the commencement of the war, the expenditure under these three heads increased steadily, although the rate of increase was slower than that needed by the necessities of the case. But, during the war, progress in these matters was largely arrested, and it was not until 1919-20 that an appreciable advance was made. This becomes evident from the fact that, while the total expenditure increased from £ 82.8 million in 1913-14 the last pre-war year to £ 112.1 million in 1918-19, excluding the special and additional liability of £ 12.7 million underta en later in the year, *i. e.* an increase of £29.3 million the expenditure on education, sanitation, and medical relief increased from £ 4.2 million in 1913-14 to £ 5.2 million only in 1918-19.

[TABLE.

Net Expenditure on Education, Medical Relief and Sanitation in £ million.

Year.	Education.	Medical and Sanitation.	
1911-12	2.0	1.0	
1912 13	2.5	1.1	
1913-14	3.0	1.2	
1914-15	3.0	1.4	
		Medical.	Sanitation.
1915-16	2.8	.8	.6
1916-17	2.8	.8	.5
1917 18	3.1	.9	.6
1918-19	3.7	.9	.6
1919-20	4.2	1.2	.8

Table No. 14.

In the very first year of the war, the Provincial Governments were not allowed by the Government of India to spend fully the grants made to them by it for these reforms, and consequently the actual expenditure on education, and on sanitation and medical relief for 1914-15 was £ .7 and .4 million less than the budgeted expenditure. The policy of retrenchment in these matters was continued, and the actual expenditure on education in 1915-16 and the next two years was less than the budgeted expenditure. If retrenchment was necessary on account of the financial situation resulting from the war, it is probable that it could have been carried out in respect of the rapidly growing expenditure on such heads as police and the salaries of Civil Establishments, and that these heads could have been spared in view of the necessity of their rapid

progress. It is true that in 1917-18 the Government of India gave a special annual recurring grant of £.2 million, to be distributed among the Provinces for improving the training and pay of teachers in primary and secondary schools, and that in 1918-19 two similar grants of the same amount were made for the extension of primary and technical education. In making these grants the Finance Member, while admitting that they were small in comparison with the vast and urgent requirements of India in these matters, explained that it was an earnest of the Government's intention of making more liberal provision for education on the return of peace, and that it was not possible to make a larger grant at that time, not merely on account of the financial difficulties of the war, but also for the reason that it would have been highly imprudent on the part of the Central Government to commit itself, until the radical readjustments of Central and Provincial finance contemplated by the scheme of constitutional reforms had been actually made. These were useful grants, but they served to show the slowness of the progress that was being achieved.

With regard to the Provincial Governments, it should be noted that their loss of revenues from the outbreak of the war, was much smaller than that of the Central Government, because their revenues depended to a far smaller extent upon trade conditions. On the other hand, the growth in their revenues and expenditure in the

succeeding years was very much less than the growth in those of the Central Government. This was so, with regard to the revenues, because they had to depend merely upon normal growth, no increase of taxation being made under the Provincial heads of revenue, and the yield from that under the Divided heads such as the Income tax being wholly appropriated by the Central Government for the reason stated before. The small growth of the Provincial expenditure was due to the fact that the Provincial Governments were made to adopt a policy of vigorous retrenchment, in matters not immediately essential or remunerative, by the Central Government from the very first year of the war, on account of the financial situation brought about by the war. Even in 1914-15, the Provincial Governments were not allowed to spend fully the grants which had been made to them by the Central Government for the extension of education, sanitation, medical relief and civil works. In the budgets of succeeding years, although the policy of retrenchment was continued, provision was made for the Provincial Governments to draw to a small extent upon their balances accumulated with the Central Government in past years, in order that their already insufficient commitments in respect of education, sanitation and medical relief might not be unduly interfered with, that a dead stop might not be put to all further developments in these vital matters, and that the normal standards of expenditure might not be reduced too severely. However, the Provincial Governments

made no use of this provision, because every year, the expected deficit in their revenues was turned into a surplus, either on account of an increase in their revenues or a reduction in their expenditure as compared with the budget estimates, or of both. These surpluses were added to their balances with the Central Government, which were thereby increased. The surpluses thus proved useful to the Central Government in meeting its Ways and Means difficulties. The Provincial finances were therefore so managed during to war as to assist the Central Government materially in meeting its financial difficulties.

With the cessation of hostilities, the Central Government could no longer ask the Provincial Governments to abstain from drawing moderately on the large balances to their credit with it. They were therefore now permitted to incur additional expenditure on the extension of education, in directions in which it had been specially hampered by war economies, on the development of industries, on the repair of damage caused to public institutions and services by the financial stringency of the war, and on purposes such as the development of forests, and agricultural experiments, which would secure a larger return to the State. However, the advantage of this permission was taken only to the extent of £ $1\frac{1}{4}$ million, this being the estimated provincial deficit in 1919-20 to be met by drawing upon their balances with the Central

Government. But the actual Provincial revenues almost coincided with the expenditure, and therefore the balances were not touched this year also.

It remains to consider the prospects of the revenues in the near future. Under the system existing hitherto, the receipts from Land Revenue, Income tax, Stamps, Excise and Irrigation were divided in certain proportions between the Central and Provincial Governments. The scheme of constitutional reforms, however, realised the need for the complete separation of the finances of the Central Government from those of the Provincial Governments, and for securing to the latter substantial freedom from the control of the former, in order to enable them to meet the needs of their own provinces more adequately than has hitherto been done. It has therefore been decided to credit the whole of the receipts from Income tax to the Central Government, and to make the other heads of revenue entirely Provincial. This will leave the Central Government with a deficit of Rs. 10 crores, and as the provinces will gain in revenues by the re-arrangement, it is only fair that the deficit should be made up with contributions from the provinces, which will be extinguished after a few years, when the revenues of the Central Government will have sufficiently expanded to meet its own requirements. The initial contributions are bound to be somewhat arbitrary and inequitable, because the realisation of a theoretical equity would have entailed a revolutionary

change in the existing figures of the revenues and expenditure of the various provinces. Besides, it would have been very difficult to arrive at an equitable contribution without knowing the normal expenditure of each province. It would have been unjust to penalise one province by an increase of its contribution, for its strict adhesion to economy during the war, while another province, which had increased its expenditure more freely, was rewarded by a reduced contribution. Moreove, it would have been difficult to calculate even the normal revenues under several heads, as they were liable to all the vicissitudes of a period of economic disturbances and exchange fluctuations. It has therefore been decided to base the initial contributions upon the increased spending power accruing to the Provincial Governments under the new scheme. The increase in the resources of Madras, Bombay, Bengal, the United Provinces, the Punjab, Burma, Bihar and Orissa, the Central Provinces and Assam has been calculated to amount to Rs. 6, 1, 1, 4, 3, $2\frac{1}{2}$, $\frac{1}{2}$, $\frac{1}{2}$, and $\frac{1}{2}$, crores respectively, and accordingly their contributions will be Rs. $3\frac{1}{2}$, $\frac{1}{2}$, $\frac{1}{2}$, $2\frac{1}{2}$, 2, $\frac{1}{2}$, nil, $\frac{1}{4}$ and $\frac{1}{8}$ crores respectively. It will be seen that the last four provinces are let off more easily than the others, and the reason given is that, being backward in their social, economic, and administrative conditions, they will have to commit themselves to a larger proportion of expenditure. However, the special treatment accorded to them, and penalising the major provinces for their benefit appear to be undesirable,

because, although in cases of emergency they should be assisted by means of liberal grants, normally they ought to develop their own resources and to rely on their own revenues, and because their treatment as infants may tend to weaken their self-reliance and sense of responsibility.

The initial contributions will be gradually so altered that at the end of seven years, the equitable limit based upon the capacity of the provinces to pay, will be reached. It is true that equity in these matters is as difficult to secure as the equity in taxation outlined in Adam Smith's first rule. However, the Meston Committee, after giving due weight to various factors such as the population, cultivated area, provincial revenues, amount of income tax, the extent of the consumption of textile goods, liability to famines, and indirect contributions to the Central Government through the channels of the income tax, customs and salt duty recommended the following percentages of the total contribution by the provinces as equitable : Madras 17, Bombay 13, Bengal 19, the United Provinces 18, the Punjab 9, Burma 6½, Bihar and Orissa 10, the Central Provinces 5, Assam 2½. Although the general justice of this scale of contributions may be granted, it appears that the Punjab, with growing resources and a progressive commercial life, will contribute a smaller percentage than would be equitable, and that Burma and the Central Provinces have been let off too easily. This scheme of equitable

contributions is calculated to disappear in about 10 years, when the revenues of the Central Government will have sufficiently expanded to meet its requirements.

We shall now first consider the prospects of the Imperial heads of revenue, and then conclude this chapter by dealing with the provincial heads. The net receipts from the railways exhibited a remarkable increase from 1915-16, and the question is whether the rate of increase will be kept up, or will slacken, or whether the net receipts will fall off. In considering this problem, several opposing factors must be taken into consideration. The gross receipts depend upon the number of passengers, the distances over which they are carried, and the classes in which they travel, and upon goods traffic consisting of produce carried from the interior to the ports for export, coal and other goods, and the distances over which they are carried. With the return of peace, the operation of some of the factors explained above as swelling these receipts during the war, has ceased, or is gradually weakening. The artificial inflation of the receipts by the large movements of troops and military stores has already ceased. The coal and other traffic diverted from the coastal to railway routes during the war, is returning to normal conditions, as the tonnage situation is gradually improving. The kind of activity of the internal trade, explained as resulting from the restrictions on imports, has weakened on account of their removal. However, these adverse forces will be

more than counterbalanced by the growing strength of other factors. Firstly, as India's export trade expands with the reconstruction of the industrial structure in Europe, and the growth in its effective demand for India's produce, the railways will have to carry increasing quantities of the produce from the interior to the ports. Secondly, India is on the eve of a great industrial era, and steps are being taken to carry out the important recommendations of the Indian Industrial Commission. Industrial activity in a vast country like India means that raw materials will be brought together in enormous quantities from different points, and that the manufactured commodities will have to be distributed widely. This two-fold work of the concentration of raw materials and the distribution of the finished products on a much larger scale than before will have to be performed by the railways, and will mean increased receipts. The railway expenditure is made up of the interest payments, and the cost of direction, maintenance and operation. The rise in prices is not likely to affect the first two items, in any appreciable degree, but it has already raised substantially the cost of labour and materials such as coal, stores, metals and cement required for the maintenance and operation of the railways, and as the level of prices, as explained later, is likely to remain much higher than the pre-war level, in the near future, the railway expenditure also will probably remain substantially above the pre-war figure, although some economies in the working of the

railways will become possible. Moreover, the wear and tear of the rolling stock and permanent way during the war was unprecedented on account of the heavy traffic and the lack of renewals, and it is clear that, for a few years, substantial sums will have to be spent upon renewals, after the forced neglect of the past few years. In this connection it may be noted that the reserve of £ 20 million, which the Government of India built up in 1917-18 for the purposes of railway renewal, was mostly used up by it for other purposes. Taking all these factors into consideration, it seems that the net railway receipts, depending upon the surplus available after meeting the expenditure out of the gross receipts, will not increase further in the next few years, to an appreciable extent. On the other hand, they are not likely to fall materially below the present level, because the importance of the favourable factors mentioned above appears to be considerable.

With regard to the Customs revenue, it has been suggested that the decline in prices will reduce the proceeds of those customs dues, which are levied on an ad valorem basis. But this factor does not appear to be much important, because, as explained later, the level of prices in the near future is likely to remain much higher than the pre-war level. Moreover, whatever reduction any decline in prices may bring about in the proceeds of ad valorem customs duties, will be more than counteracted by the expansion of trade that will result from the resumption of

normal conditions and from India's economic progress. The present general import tariff of $7\frac{1}{2}$ per cent will probably remain, and it will not be desirable to raise it further, unless financial necessities compel it, because it will mean an increase in the already heavy burden upon the mass of Indian consumers of imported necessaries of life.* The rate of duty upon the import of certain articles of luxury such as motor cars, tinned food, liquors, costly fabrics and furniture may be raised, but the yield is not likely to be large. However, it will be possible to secure an appreciable revenue by means of duties upon the export of articles in which India possesses a complete or partial monopoly such as rice and jute, and large advantages, such as cotton, oilseeds and hides and skins. The world shortage of raw materials will continue for some time, and the effective demand for them will become strong with the gradual disappearance of the existing trade depression and with the progress of industrial reconstruction in Europe, and therefore the duties upon the export of such articles, will mainly fall upon the importers, and will probably produce no adverse effect upon India's export trade. The export duty on jute, first levied in 1916-17 and doubled in 1917-18, and the export duty on rice, have been bringing in a useful revenue without adversely affecting their exports. These duties will most probably remain, and similar duties may be imposed upon the other

* In the budget for 1921-22, in order to meet a large deficit, the general ad valorem duty had to be raised to 11 per cent. except for certain articles of luxury, the duty on which was increased to 20 per cent.

articles mentioned above. In September 1919 the Government levied a duty of 15 per cent upon the export of raw hides and skins. This is satisfactory, but for reasons mentioned in an earlier chapter, it is difficult to approve of the decision to grant a rebate of 10 per cent, if the raw material is exported to any part of the British Empire and tanned there. On the whole, the Customs revenue may be expected to undergo a steady expansion.

There can be no question of reducing the ordinary Income tax or the Super tax. The Excess Profits Duty has disappeared, but its place may be taken by death or inheritance duties. This policy will be in accordance with the principle of laying the burden of taxation upon shoulders best able to bear it, and it may be explained that the richer sections of the community in India as compared with those in the Western countries have, in the past, hardly borne their fair share of the total burden of taxation. The revenue from salt should not be expected to show any growth. On the other hand, it is desirable that it should decrease, for this will mean that the burden upon the poor man in respect of a necessity of life will be reduced. As regards the Opium revenue, it declined materially after the agreement with China in 1911, but improved considerably from 1916-17 on account of larger sales to the Straits Settlement in accordance with an agreement with its Government, and the replacement of Turkish opium by the Indian

product for medicinal purposes in England. The sale to the Straits Settlement may be expected to continue, but it is doubtful whether the Indian opium will be able to hold its own against Turkish opium in the English market. This is one of the many matters of trade in which England can reciprocate towards India without any appreciable loss to herself. On the whole, however, no increase under this head of revenue, can be expected. With regard to the interest receipts, they increased immensely during the war on account of temporary investments of the Secretary of State's inflated cash balances, and of large investments on behalf of the Paper Currency Reserve. But a large part of the surplus balances will be utilised for various purposes, and the interest derived from their investment will gradually diminish. On the other hand, the receipts from the investments of the Paper Currency Reserve, although declining temporarily, will ultimately recover, because, as explained before, the loss of the Reserve resulting from the rise in the sterling value of the rupee will be made up in a few years, out of the gain from exchange. On the whole, therefore, this head of revenue may show some decline.

Coming to the provincial heads of revenue, the land revenue will undergo only normal growth, and no considerable increase can be expected. Whether the land revenue is a rent as maintained by the Government, or a tax as asserted by some Indian economists, its burden

is already heavy enough in tracts under the Temporary Settlement, and it is not capable of any substantial increase. The tracts under the Permanent Settlement are paying much less than they ought to do, but the Government cannot go back upon the Permanent Settlements shortsightedly made by Lord Cornwallis against the better judgment of Sir John Shore. The revenue from Stamps and Irrigation also will undergo a normal growth with the economic progress of the country. The Excise revenue has increased considerably in recent years, but its reduction is desirable for the sake of the sobriety and health of the mass of the population. The Provincial Governments, however, can derive a large revenue in the near future from the development of their forest wealth, which has been almost neglected so far.

Thus, on the whole, the total revenue of the country may be expected to expand steadily. But it is necessary to emphasise that the rate of expansion will be slow, and that therefore an increase in the expenditure in directions where it is urgently needed, will become possible only by cutting it down in other directions.

GENERAL STATEMENT OF THE WAYS AND MEANS POSITION IN ENGLAND AND INDIA COMBINED.

Outlay in £ million	1914-15 Budget	1914-15 Revised	1915-16 Budget	1915-16 Rev.	1916-17 Budget	1916-17 Rev.	1917-18 Budget	1917-18 Rev.	1918-19 Budget	1918-19 Rev.	1919-20. Budget	1919-20. Rev.
Capital Outlay on :—												
Railways	12.0	11.6	8.0	4.9	3.0	1.5	3.6	3.1	4.2	4.4	17.7	10.2
Irrigation	1.2	1.2	1.1	0.6	0.9	0.6	0.6	0.5	0.5	0.3	0.4	0.3
Delhi	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Discharge of debt	0.7	0.6	1.0	4.0	2.0	2.1	0.9	2.7	5.9	4.6	..	2.0
Imperial deficit	..	..	2.8	2.0	..	..	..	..	..	4.3	..	14.4
Provincial deficit	3.2	2.2	1.0	0.6	0.4	..	0.1	..	..	..	1.6	..
Net issues of Imperial and Provincial Loans	0.1	0.1	..	..	..	..	..	..	..	1.3	0.8	0.9
Unfunded Debt	..	..	0.2	..	..	..	..	..	..	..	..	..
Famine insurance and miscellaneous items	..	..	..	1.1	..	..	..	..	..	..	..	..
Discharge of temporary debt ..	..	..	14.0	11.0	9.5	9.5	..	..	..	..	..	..
Purchase of military stores awaiting allocation	..	..	..	..	..	1.8	..	2.1	..	12.7	..	..
Purchase of Home Treasury Bills	..	..	..	..	..	..	..	20	..	..	..	..
Discharge of Treasury Bills in excess of issues	..	..	..	..	..	..	..	0.2	..	10.7	8.0	..
Debit for purchase of silver ..	..	..	..	..	..	..	..	..	..	..	..	..
Credits in favour of Federal Reserve Bank of New York ..	..	..	..	..	..	..	..	2.7	..	..	..	..
Repayment of assets of hostile firms held in deposit by Government	..	..	..	..	..	..	..	..	..	..	2.4	..
Payment to Home Government of balance of Indian War Loan proceeds in reduction of £ 100 million contribution ..	..	..	..	..	..	..	..	..	..	..	8.9	8.8
Refund to War Office of amount recovered in excess in previous year	..	..	..	..	..	..	..	..	..	..	..	3.0
Total	17.9	16.1	28.4	24.8	16.1	15.8	5.3	31.6	10.9	38.6	40.1	39.9

Assets in £ million	1914-15 Budget	1914-15 Rev.	1915-16 Budget	1915-16 Rev.	1916-17 Budget	1916-17 Rev.	1917-18 Budget	1917-18 Rev.	1918-19 Budget	1918-19 Rev.	1919-20 Budget	1919-20 Rev.
From balances	4.9	2.6	4.5	5.0	0.3	..	1.1	..	3.6	8.5	2.1	4.6
Imperial Surplus or deficit ..	1.3	—2.7	..	..	1.1	5.8	0.1	5.8	2.2	..	0.9	..
Provincial surplus or deficit ..	..	..	..	..	..	1.5	..	2.3	..	1.1	..	..
Rupee borrowing	3.3	10.6	3.0	3.3	4.3	4.5	..	..	..	..	10.0	14.2
Sterling borrowing	5.9	10.9	6.5	3.1	..	..	..	..	..	..	..	..
Unfunded debt	1.8	—5.1	..	6.7	0.3	1.7	2.0	0.6	1.2	1.8	4.3	..
Famine insurance and miscellaneous	0.7	—0.2	0.4	..	0.2	1.5	..	..	..	..	..	—0.2
Special war receipts	..	..	..	1.7	0.4	1.0	0.6	0.2	0.2	..	..	..
Renewal of temporary debt ..	..	..	14.0	11.0	9.5	..	..	..	..	..	..	..
Credit for silver purchased in previous year	..	..	..	..	..	..	1.7	..	1.0	..	5.2	11.2
Receipts from Indian Treasury Bills	..	..	..	..	..	..	..	30.0	...	4.0	..	0.2
Repayment of credits placed at the disposal of the Federal Reserve Bank of New York in previous year	..	..	..	..	..	..	..	..	2.7	..	..	..
Excess of proceeds of War loan over payments to Home Government	..	..	..	..	..	..	..	..	..	4.2	..	..
Withdrawal from Special Reserve	..	..	..	..	..	..	..	..	..	13.1	6.9	6.9
Recovery from War Office in respect of stores charged to suspense head	..	..	..	..	..	..	..	..	..	5.9	11.1	..
Net gain on exchange held in suspense for meeting deficiency in Paper Currency Reserve ..	..	..	..	..	..	..	..	..	..	..	..	3.[illegible]
Total	17.9	16.1	28.4	24.8	16.1	16.0	5.5	38.9	10.9	38.6	40.5	39.9

Table 15.

General Statement of the Ways and Means Position in India.

Outlay in £ Million	1914-15 Budget	1914-15 Rev.	1915-16 Budget	1915-16 Rev.	1916-17 Budget	1916-17 Rev.	1917-18 Budget	1917-18 Rev.	1918-19 Budget	1918-19 Rev.	1919-20 Budget	1919-20 Rev.
Recoverable disbursements on behalf of Home, Australian and East African Governments. ..	..	8.8	9.1	13.1	18.6	33.5	39.0	63.0	73.2	76.0	36.4	67.3
Council Bill drawings	20.0	7.5	7.1	20.0	3.9	33.0	..	34.8	..	18.6	9.7	34.5
Foreign money orders on India ..	..	..	..	..	..	..	..	5.3	1.2	4.2	..	..
Credits for Federal Reserve Bank of New York	..	..	..	..	..	..	..	2.7	..	..	..	..
Repayment of temporary loan taken from the Bank of Bombay in the previous year	..	..	..	..	..	..	..	..	2.7	2.7	..	..
Excess of Treasury Bill payments over receipts	..	..	..	..	..	..	..	..	..	10.7	..	..
Cost of military stores purchased in advance of allocation to definite objects.	..	..	..	..	..	..	..	..	..	12.7	..	..
Rupee credits for Federal Reserve Board in part payment for purchase of American silver	..	..	..	..	..	..	..	..	..	11.0	..	..
Remittance of gold in part payment of the same	..	..	..	..	..	..	..	..	..	2.0	..	..
Additional takavi loans	..	..	..	..	..	..	..	..	..	1.4	..	..
Net issues of Imperial and Provincial loans	..	..	..	..	..	..	..	..	..	..	0.8	1.3
Capital Outlay.	..	..	..	..	..	..	..	..	..	..	..	3.1
Discharge of Treasury Bills. ..	..	..	..	..	..	..	..	..	..	..	8.0	..
Council Bills drawn at the end of the previous year but payable at the beginning of the year ..	..	..	..	..	..	..	..	..	2.0	2.0	..	..
Miscellaneous.	..	..	..	..	..	..	..	..	..	2.0	..	..
Discharge of Debt and Cash Certificates.	..	..	..	..	..	..	..	..	..	..	..	4.5
Transfers to currency against withdrawals by S. of S. of Home Treasury Bills held in P. C. R.	..	..	..	..	..	..	..	..	..	..	..	19.7
Total	20.0	16.3	16.2	33.1	22.5	71.5	39.0	110.8	79.1	141.3	54.9	130.4

Assets in £ million	1914-15 Budget	1914-15 Rev.	1915-16 Budget	1915-16 Rev.	1916-17 Budget	1916-17 Rev.	1917-18 Budget	1917-18 Rev.	1918-19 Budget	1918-19 Rev.	1919-20 Budget	1919-20 Rev.
Excess of revenue over expenditure in India.	21.3	16.9	15.8	17.7	22.5	33.0	24.5	31.5	22.1	13.0	18.0	13.6
Reduction of balances	2.3	1.7	1.4	3.3			..	..	5.0	5.4	2.1	5.0
Fresh coinage of silver	..	..	..	..	..	19.5	4.0	13.3	13.0	56.3	..	..
Issue of currency notes against investments in London on behalf of the Paper Currency Reserve	..	..	..	..	..	19.0	..	8.7	16.3	24.7	..	..
War loan including cash certificates	..	..	..	..	..	..	10.0	34.5	20.0	37.1	10.0	21.3
Net issue of Treasury Bills. ..	..	..	..	..	..	..	..	30.0	..	..	..	0.3
Profits on rupee coinage	..	..	..	..	..	..	..	1.4	..	..	..	..
Difference between outstanding of Council Bills at the beginning and end of the year.	..	..	..	..	..	..	0.5	..	..	..	..	..
Repayment of credits granted to Federal Reserve Bank of New York in the previous year. ..	..	..	..	..	..	..	..	..	2.7	..	..	..
Receipts from the sale of reverse councils	..	..	..	..	..	..	..	..	..	4.8	..	18.4
Credits for the issues of stores charged to suspense account..	..	..	..	..	..	..	..	..	..	..	11.1	..
Credits from silver purchased by the Secretary of State.	..	..	..	..	..	..	..	..	..	..	16.2	22.7
Credits from gold purchased by the Secretary of State	..	..	..	..	..	..	..	..	..	..	..	38.8
Savings Bank etc. deposits ..	..	..	..	..	..	..	..	..	..	..	..	3.6
Miscellaneous	..	..	..	..	..	..	..	..	..	..	..	6.7
Total	23.6	17.6	17.2	21.0	22.5	71.5	39.0	119.4	79.1	141.3	57.4	130.4

Table 16.

General Statement of the Ways and Means Position in England.

Outlay in £ Million	1914-15 Budget	1914-15 Rev.	1915-16 Budget	1915-16 Rev.	1916-17 Budget	1916-17 Rev.	1917-18 Budget	1917-18 Rev.	1918-19 Budget	1918-19 Rev.	1919-20. Budget	1919-20. Rev.
Ordinary Home Charges, including capital outlay	27.8	26.5	25.3	22.7	21.8	21.7	24.0	25.0	22.3	22.9	39.7	36.2
Discharge of India Bonds and railway debentures	0.7	0.6	1.0	1.0	2.0	2.0	0.9	2.1	3.1	1.8	..	..
Discharge of temporary war debt	..	..	..	3.0	..	9.5	..	..	..	..	..	..
Investments on behalf of Gold Standard Reserve	..	0.6	..	7.5	..	4.3	..	1.4	..	..	..	..
Investments on behalf of Paper Currency Reserve												
Purchase of Silver	..	..	..	8.5	..	19.0	..	8.7	16.3	20.7	..	..
Payments to the Treasury of the proceeds of Indian war loan.	..	..	..	..	..	16.2	4.0	13.5	12.0	44.0	11.0	6.9
Special investment in Home Treasury Bills for future liabilities	..	..	..	..	..	..	10.0	35.1	20.0	33.4	8.9	8.8
Addition to balances.	..	..	..	..	..	..	..	20.0	..	..	..	..
Sterling transfers on London ..	..	..	..	..	..	..	..	..	1.3	..	..	..
Repayment of assets of hostile firms in deposit by Government in India	..	..	..	..	..	..	..	..	..	5.4	..	24.7
Miscellaneous transactions ..	..	..	..	..	..	..	..	..	..	..	2.3	..
Purchase of gold	..	..	..	..	..	..	..	0.4	..	3.1	..	4.7
	..	..	..	..	..	..	..	..	..	..	..	32.1
Total	28.5	27.7	26.3	42.7	23.8	72.8	38.9	106.2	75.0	131.3	61.9	113.4

Assets in £ Million.	1914-15 Budget	1914-15 Rev.	1915-16 Budget	1915-16 Rev.	1916-17 Budget	1916-17 Rev.	1917-18 Budget	1917-18 Rev.	1918-19 Budget	1918-19 Rev.	1919-20 Budget	1919-20 Rev.
Receipts from Council Bills, ..	20.0	7.5	7.1	20.0	3.9	33.0	..	35.3	..	20.9	10.3	31.2
Recoveries from Home, Australian and East African Governments.	..											
Reduction of balances		8.8	9.6	16.1	18.6	38.5	39.0	67.1	75.0	89.9	40.7	61.0
Sterling borrowing	2.6	0.5	3.6—	4.6	1.3	1.3	..	..	..	3.1	2.1	1.2
Receipts from money-orders ..	5.9	10.9	6.5	3.1	..	..	..	..	..	..	..	..
Withdrawals from special reserve	..	..	..	..	..	..	..	5.3	..	4.3	..	..
Subscriptions to Indian war loan in London	..	..	..	..	..	..	..	..	..	13.1	6.9	6.9
Receipts from sale of wheat ..	..	..	..	8.1	..	..	..	1.1	..	..	..	..
Miscellaneous transactions ..	..	..	..	..	..	..	..	..	..	..	..	..
Transfers to Home Treasury from investments on behalf of Paper Currency Reserve.	..	..	..	..	..	..	..	..	..	..	1.9	13.1
Total	28.5	27.7	26.3	42.7	23.8	72.8	39.0	108.8	75.0	131.3	61.9	113.4

Table 17.

CHAPTER V.

The Difficulties and Problems of the Ways and Means of Government Finances.

In the last chapter, the revenues of the Government of India, and its expenditure charged to the revenues were dealt with. Outside this revenue account, however, the Government has annually to make large disbursements in connection with several matters, such as various kinds of capital outlay and discharge of debt, and to secure funds in diverse ways, such as by means of permanent or temporary borrowing, from the accumulated balances, and from the savings bank deposits, in order to be able to make the disbursements. The Ways and Means position explains these receipts and disbursements of the Government outside the revenue account. The examination of this position in this chapter, will be based upon an analysis of the figures of its revised estimate framed a month before the end of each year and given in tables 15-17 because the actual figures are neither published, nor obtainable in any other way. However, as the difficulties which the Government had to face in this respect, and the ways in which they were met, are brought out quite as well by the figures of the revised estimate, as they would have been, if the actual figures had been available, and as this chapter is concerned only with an examination of the difficulties and their solution, the differences that may

exist between the two sets of figures may be disregarded. For examining the forces and factors which were at work during the period, and the difficulties caused by them, the war period may be divided into two parts, the first extending over 1914-15 and 1915-16, and the second over the subsequent years, because the forces at work and the difficulties resulting therefrom, were different during the two parts and different measures had to be taken to meet the difficulties. During the first part, India suffered from the effects of the outbreak of the war. Those effects disappeared by the end of 1915-16, and new problems and considerations arose by that time. However, it should be noted that this division of the war period is not meant to be hard and fast, because the factors, which became prominent during the second part of the period, had already begun to make themselves felt during the first part. But, as they exhibited little strength, and caused no appreciable difficulties during the first part, this twofold division of the war period does not appear to be out of place.

During the first part of the war period, two factors *viz.* the loss of confidence in the financial soundness and stability of the Government of India, mainly on the part of the ignorant masses, and the acute depression in India's export trade, were in operation, and the Ways and Means difficulties which they caused were the run upon the Postal Savings Banks, the Paper Currency Offices and the

Treasuries, and the fall in exchange necessitating the sale of reverse Council drafts in Calcutta. The public confidence in financial institutions had been shaken by the failure of a large number of Indian Joint-Stock Banks in 1913-14, and the baseless rumours circulating in the bazaars about imaginary defeats of the Allied armies, together with the mischief wrought by the German cruiser the Emden in Indian waters for a few months till it was caught, which seemed to give colour to these absurd rumours, created a panic mainly among the ignorant masses, and they made a heavy run upon the Postal Savings Banks. For some months before the war, the deposits in these banks had been increasing under the stimulus of the new facilities granted by the Government which raised the limit on annual deposits in these banks from Rs. 500 gross to Rs. 750 net, and also the total amount that could be held by a depositor from Rs. 2,000 to Rs. 5,000, and at the beginning of the war the total deposits in these banks amounted to Rs. 24.3 crores. But, the run was so heavy that during the months of August and September deposits amounting to Rs. 6 crores were withdrawn, and the amount withdrawn came to Rs. 10½ crores by the end of 1914-15. There was a similar demand for rupees in return for currency notes, especially acute in Bombay. Ignorant people became eager to realise their assets, as they believed that the notes which they possessed would lose all their value in a short time, and they made a serious run upon the Paper Currency Offices and district treasuries with

the result that the active circulation of notes fell from Rs. 51.9 crores on 1st February 1914 to Rs. 45.1 crores on the same date in 1915. The run upon the Postal Savings Banks was undoubtedly to a very large extent the result of panic, but it is difficult to agree with the view taken by the Finance Member that the run was wholly due to the panic. The reason is that owing to the acute depression in India's export trade, the raw materials grown by the agriculturists, who form 70 per cent of the entire population, could be sold only at low prices to middlemen, and those who were seriously affected by this fact, had to use up the small reserves that they had created in the Savings banks, in order to maintain themselves and tide over the bad period. However, it must be admitted that by far the larger amount of these withdrawals was the result of the panic.

The policy pursued by the Government in meeting these two runs and restoring confidence was altogether praiseworthy. One of the practical maxims of banking is that the best means to allay a panic and stop the run upon a financial institution is to make full and prompt payments in response to the demand. The Government did this with courage and promptitude, even increased the facilities for the encashment of notes, and met all the demands fully and promptly. This policy was eminently successful, the panic soon gave way to renewed confidence, the deposits in the savings banks and the active circulation of notes

began to show a tendency towards an increase in the latter half of 1915-16, and by the beginning of 1916-17 the conditions regarding these two matters became quite normal and stable. During the second part of the war period, the note circulation increased so rapidly as to become a source of danger, and although the deposits in the Postal Savings Banks increased slowly, this was not due to any want of confidence, but to the fact that the issue of postal cash certificates in connection with the war loans proved a superior attraction, and appropriated those savings which othersise would have increased the deposits of the Postal Savings banks. There was no reason to regret this, as it was advantageous to the Government of India to have deposits, which were practically at call, transferred to more permanent indebtedness. The following figures show the position of the deposits since 1914. It will be noticed that their level on March 31st 1919 was still 19 per cent below that on the same date in 1914.

Deposits in Post Office Savings Banks in Crores of Rupees.

31st. March	1914	23.17
1st. August	1914	24.5
31st. March	1915	14.89
,,	1916	15.32
,,	1917	16.60
,,	1918	16.59
,,	1919	18.83

Table 18

The runs upon the Savings banks, and Currency Offices were successfully met, but this required large funds. The run upon the Savings banks was equivalant to a run on the Government Treasury balances, since these deposits are unfunded and treated as a part of the Government balances. Moreover, although war disbursements by the Government of India on behalf of the Home Government became a prominent factor only during the second part of the war period, these disbursements to a much smaller extent had to be made during the first part also. The result was that the treasury balances of the Government of India began to be depleted. The Government therefore had to borrow £ seven million from that part of the Gold Standard Reserve which was held in India, and which had become swollen through the sale of reverse Council Bills. This sale arose from the fall in the exchange, which resulted from the depression in India's export trade, which was specially acute during the first months of the war. To support the exchange the Secretary of State had to discontinue the sale of Council drafts, and the Government of India had to sell reverse Council drafts in Calcutta, to the extent of £ 8.7 million by the end of 1914-15. The sums received in India from the sale, were credited to that part of the Gold Standard Reserve which was held there, as they were withdrawn from the part held in England to cash the Bills. Owing to the discontinuance of his sale of Bills, the Secretary of State was unable to obtain the funds sufficient to meet his Home Charges. He obtained

a substantial sum from the Home Government in the form of the recovery of an equivalent sum disbursed by the Government in India on behalf of the Home Government in the purchase of war material, but this sum did not make up the deficiency caused by the stoppage of the sale of Council Bills. He therefore raised a temporary debt of £ 7 million by floating India Bills in lieu of the addition of £ 4.5 million to the permanent debt, which the budget for 1914-15 had provided and in addition increased his borrowing through the Railway Companies by £ 2.6 million. The export trade, however, began to recover in 1915-16, the weakness in exchange disappeared, the sale of Council drafts was resumed, by the beginning of 1916-17 the export trade recovered more than the import trade, and during the second part of the war period the demand for Council drafts became so great that the Secretary of State could not satisfy it fully. Thus by the beginning of 1916-1917 the effects of the outbreak of the war and the Ways and Means difficulties resulting therefrom had disappeared, new problems arose, new difficulties confronted the Government of India, and new solutions were required. We shall therefore now turn to the second part of the period.

The Ways and Means problem has always been a double one. The Government has to provide not merely that its total resources in England and India together are sufficient to meet the call upon them, but also that

the funds are where they are required, *i e.* are properly distributed between England and India. One of these two sides of the problem has been much more important than the other. Thus, before the war the usual difficulty was to obtain sufficient total funds to meet productive capital expenditure, and there was generally no difficulty regarding their distribution, for trade demands could be depended upon for being more than enough to take up the Council Bills by which funds were remitted to England. Each year the Secretary of State required funds to meet his Home Charges, for the purchase of silver and railway and public works material, and for the investments in London on behalf of the Paper Currency and Gold Standard Reserves. These funds used to be transferred from India to England by means of the Council drafts which were sold by the Secretay of State and cashed by the Government in India. The normal favourable trade balance of India *i. e.* the excess of the exports over the imports was thus made good partly by the mechanism of Council bill drawings, and partly by the import of the precious metals by private agency. The Government had thus to depend for the transfer of necessary funds from India to England upon the sale of Council drafts, which, together with the private import of the precious metals, used to satisfy fully the remitttance demands of trade.

During the second part of the war period, however, the first aspect of the Ways and Means problem, namely, the

sufficiency of the total resources, ceased to be important. Firstly, it is true that it became at first difficult and then impossible to borrow in London. In the first financial year of the war, it became possible to meet the initial Ways and Means difficulties by borrowing £ 10.9 million in London, although the budget had provided for £ 5.9 million only. But in the next year the actual borrowing fell to £.3 million as against the £ $6\frac{1}{2}$ million which the budget had taken into account, while from 1916-17 it became impossible to borrow at all, because it was considered necessary not to draw upon the resources of the London money market, so as to conserve them for the purpose of the prosecuticn of the war. On the contrary, the Government of India discharged the temporary debt raised in London in the early part of the war period and lent large sums to the Home Government by means of investments in British Treasury Bills. Secondly, it is true that, although large sums were borrowed in India in 1917-18 and 1918-19 they were not available for capital expenditure, as they were used for the partial liquidation of the war gift of £ 100 million to the Home Government. However, these considerations were not important, because during the war, as shown in table 15, the capital expenditure on productive works was considerably reduced in view of the necessity of refraining from undertaking financial responsibilities which were not urgent, while the war was in progress.

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It should be noted that the provision for capital outlay on railways and irrigation declined progressively throughout the period, except in the case of railways in 1919-20, and that the actual outlay was invariably less than the provision made for it. The difficulties of importing railway material from the United Kingdom increased with the progress of the war, and so did the prices of whatever could be imported. Larger allotments for railway capital expenditure could hardly have been profitably utilised under such conditions, even if they had been permitted by the financial situation, and therefore it appears that the reductions made on account of financial considerations had no material effect. The outlay therefore was confined to that work on lines open or under construction, which could not be postponed until the advent of peace, without serious loss or inconvenience, and the construction of new lines was not commenced unless it was immediately essential. In 1919-20 a very large provision, amounting to £ 17.7 million, was made, far in excess of the largest programme (£.12 million) ever previously undertaken, and also of the maximum programme recommended by the Mackay Committee, *viz* £12½ million. This was in addition to the provision of £6½ millions in the rail way revenue budget, for outlay on renewals. The actual outlay, however, amounted to £7½ million less, on account of the continuing shortage of railway material in England and its high price. With regard to irrigation, the reduction in capital outlay was very serious, considering the fact

that in 1913 only 19 per cent of the total cropped area of the country was irrigated, 8.2 per cent from canals, 5.6 per cent from wells, and 2.5 per cent from tanks, although famines visited the country periodically with disastrous effects, the last famine spreading over the land in 1918-19. The provision of a small sum of less than £½ million for this purpose, even after the termination of the hostilities was in sharp contrast to the provision of the above mentioned huge sum for the railway programme. The reasons given for this reduction were, the completion of the big schemes, the deputation of engineers on millitary service, and the difficulty of importing cement from abroad, and the utilisation of the quantities produced in the country for millitary purposes. In the matter of the construction of Delhi, the outlay was reduced to a bare working minimum, just sufficient to carry on the work already in progress, and so to prevent the deterioration of material and the dismissal of establishments.

During the second part of the war period, the second aspect of the Ways and Means problem, *viz.* the proper distribution of the available resources between India and England, became most important. With the progress of the war, the Government had to disburse in India larger and larger sums mainly on behalf of the Home Government and secondarily on hehalf of the Australian and East African Governments in connection with the purchase of war material, raw and partially and fully

manufactured, and the prosecution of military operations in Egypt, Palestine, Mesopotamia and German East Africa.

War Disbursements in India on behalf of the Home, Australian and East African Governments in £ million.

			Budget	Revised.
1914-15	..	..	..	8.8
1915-16	..	..	10.1	23.6
1916-17	..	..	18.6	38.5
1917-18	..	..	39.0	66.0
1918-19	..	..	73.2	76.0
1919-20	..	..	36.4	67.3

Table 19.

These figures show how the war disbursements in India grew larger until in 1918-19 they nearly equalled the total revenues of the Central Government in India. It naturally became very difficult for it to find funds to make these enormous disbursements. These sums were recovered by the Secretary of State in London and far exceeded his financial requirements. His Home Charges continued normal, his purchase of railway and public works material was reduced on account of the reduction of the productive capital expenditure. His purchase of silver increased, but owing to the high price of, and keen competion for silver, it was much less than was necessary. The war expenditure in India against corresponding recoveries

by the Secretary of State in London operated, so far as he and the Government of India were concerned, in the same manner as the sale of Council drafts, and removed their pre-war dependence upon it for the remittance of the necessary funds from India to England. It, therefore, became unnecessary for the Secretary of State to sell Council drafts, while the shortage of funds in India for encashing them, rendered it desirable that their sale should be cut down as much as possible. But, the war disbursements in India against the recoveries in London, while operating in the same way as the sale of Council drafts from the point of view of the Secretary of State and the Government of India, did not, like the system of Council bill drawings, meet the demands of trade in respect of private remittances to India. Moreover, while the ability of the Government of India to meet the trade demands for Council drafts became less on account of the depletion of its treasury balances by the war disbursements, the demands increased. Under the war conditions, India's exports became larger as compared with the level to which they fell during the first year of the war, because they were urgently needed for the prosecution of the war, while the same conditions prevented any considerable recovery on the part of the imports, on account of the concentration of the Western manufacturing countries upon the war and the scarcity of freight. The result was that the favourable balance of trade *i.e.* the excess of the exports over the imports increased. Of the three pre-war methods

of meeting this balance, the import of an appreciable quantity of gold was considered impossible on account of the supposed necessity of conserving the central gold resources of the Empire, while the Government of India prohibited the import of silver on private account in order to check private competition for it with the Secretary of State, who in spite of this measure found silver, on account of its high price and the general keen competition for it, increasingly difficult to obtain. The Government of the U. S. A. also from September 1917 forbade the export of gold and silver without a special license. It is therefore easy to understand why the demand for Council drafts to meet the growing favourable trade balance increased.

The Government of India endeavoured to contract the exports by restricting and prohibiting those exports which were not urgently needed for war purposes and it did this by controlling the operations of the Exchange Banks in connection with the financing of the export trade, which consequently suffered to a considerable extent. But it was impossible to restrict the exports necessary for war operations, and consequently a certain amount of Council Bills had to be sold in London and cashed in India every year. The following figures show that the amount was large, yet it fell short of the demand, generated and increased exchange difficulties, and further restricted India's export trade.

The Sale of Council drafts in London in £ million.

	Budget.	Actual
1914-15	20.0	7.7
1915-16	7.1	20.3
1916-17	3.9	33.0
1917-18	No Provision	34.9
1918-19	,,	20.9
1919-20	10.3	31.3

Table 20.

In the budgets for the first three years, the Finance Member was able to make some specific provision for the cashing of Council Bills, which, however, was much exceeded. But in 1917-18 and 1918-19, he was unable to make any definite provision for the purpose, and had to trust to securing additional funds by some means or other. Yet the actual cashing of Council Bills came to large sums, but it fell short of the demand. This restriction on India's export trade was one of the numerous war sacrifices made by India. There was a tendency in the other parts of the Empire to ignore India's many indirect sacrifices and to look to her direct war contributions only. It is therefore pleasing to find that the Viceroy and the Finance Member emphasised the point that the trade restrictions and exchange difficulties resulted from an essential service which India rendered to the Empire in financing war expenditure abroad, and so assisting in securing the United Kingdom's

exchange position, and that the acute inconveniences resulting therefrom, should be considered and readily accepted as a war sacrifice, which India made for the Empire.

Considering the figures of Tables 19 and 20 together, one realises how enormous became the total disbursements made by the Government of India, the corresponding amounts of which were obtained by the Secretary of State in London. Further, these tables bring out the fact that the budget anticipations and provisions during the second part of the war period with regard to the remittances to England, the war disbursements and the Council bill drawings became merely formal and nominal. The Finance Member was very uncertain as to how things would turn out, and gave only tentative estimates based upon the incomplete and imperfect data available. His calculations with regard to the Council bill drawings and the remittances were surpassed, and the war disbursements on behalf of the Home Government were made as the need for them arose.

The Government of India managed to make the war disbursements and to pay the Council bills, the total amount of which far exceeded the revenues of the Central Government in 1917-18 and the subsequent two years, besides meeting its own expenditure, by developing a number of resources, some praiseworthy, others open to objection. The resources of the Provincial

Governments were available only for meeting their own expenditure, so that the resources of the Central Government only could be used for making the total disbursements. (1) The Central and Provincial surpluses amounting together to the large sums of £9.9 and 10.1 million in 1916-17 and 1917-18 proved very useful. The Provincial surpluses must here be taken into account, because, being added to the balances of the Central Government, they became a central resource until the return of peace, when they were to be drawn upon by the Provincial Governments for accelerating progress in important matters. But it was not a very sound principle to take these large sums permanently from the pockets of the tax payers, especially when they were seriously affected by the war, to meet temporary Ways and Means difficulties. From the currency point of view, however, as tending to check inflation, this resource was beneficial. (2) The war loans of 1917-18 and 1918-19 including the cash certificates brought in £34.5 and £37.1 million respectively, and although the sums were paid to the Home Government in part liquidation of the war gift of £100 million, the Government of India obtained their use in India, and the payments to the Home Government were made by the Secretary of State in England. The proceeds of the loan of 1919-20 also proved very useful to the Government in meeting its heavy liabilities. The actual proceeds considerably exceeded the budget estimate, in spite of the facts that n 1917 and 1918 the Government had dipped heavily

into the pockets of the investing public, that no attempt was made to repeat the special propaganda associated with the two war loans, and that a very large number of new company issues competed with the Government loan operations. This was a very valuable and entirely praiseworthy resource for three reasons. Firstly, the difficulty mentioned above, of securing to Indian agriculturalists the payment for their excess of exports could be avoided in so far as they were prepared to give credit for the amount due to them instead of insisting on immediate payments in kind or cash, and the war loans were in effect the grant of this credit. Secondly, the subscriptions to the war loans checked the large absorption of currency by the rural districts brought about by the contraction of the imports. Before the war, every year the rupees and notes of the commercial centres were distributed in the rural districts during the busy agricultural season for the purchase of raw materials and foodstuffs for export, and during the rest of the year a large part of the currency returned to the commercial centres for the purchase of the imported articles consumed by the rural districts. But during the war the improvement in the value of the exports augmented the outward flow of currency from the commercial centres, while the contraction of the imports checked the inward flow. The absorption of currency by the agricultural districts therefore increased and it became difficult for the Government to provide continually large quantities of fresh currency for

distribution among the rural districts for the purchase of raw materials for export. The war loans, however, in so far as they were subscribed to by the agricultural districts, checked the absorption of currency, by returning a part of the absorbed currency to the commercial centres, and thus relieved to some extent the need of the Government for fresh currency. Thirdly, the loans not merely stimulated thrift and saving, but also checked the wasteful hoarding habit for which the Indian cultivator is more notorious in the West than he really deserves to be according to the facts of the case. It is true that the proceeds of the war loans were used for unproductive war purposes and not for any beneficent productive expenditure, but they proved useful for the promotion of the habits of saving and investment, which are being turned into productive channels with the return of peace. For these three reasons it was unfortunate that the Government did not develop this valuable resource earlier than in 1917-18. The Finance Member was urged in 1915-16 and especially in 1916-17 by some Indian economists and industrial leaders to make use of this resource, but he was doubtful of its success on the ground of the difficulties created by the war. He, no doubt, floated rupee loans in India in these two years, but this was done in accordance with the pre-war system of giving facilities to and obtaining some money from the leading banks and financial houses only, and was unaccompanied by the campaign of wide publicity all over the country, the

grant of extensive facilities to suit the conveniences of large and small and industrial and agricultural investors, the strong appeal to their patriotism, the creation of a special and extensive machinery to deal with the matter, and the strenuous efforts of all the district officials in this connection, which were the marked features of the war loans of the subsequent two years, and which alone brought about their marvellous success. The doubts of the Finance Member in 1915-16 may be excused, because in the first half of that year India's recovery from the effects of the outbreak of the war was not substantial. But it is difficult to appreciate his doubts in 1916-17, because India's export trade had already revived, and owing to the reduction of imports, more money was available for investment, only if judicious means had been employed for securing it.

(3) Another resource used by the Government of India for making disbursements was the issue of short-term Treasury Bills from 1917-18 maturing in 3, 6, 9 and 12 months. These were meant o secure the floating money, which was available for short periods, especially during the slack season, and which therefore could not easily be invested in the war loans. These bills brought in £ 30 million in 1917-18, but in 1819-19 their discharge in excess of their issue amounted to £10.7 million. This was probably due to the great success of the war loan in 1917-18 and especially to its success in the next year.

The long-term war loan did not compete with the Treasury bills for the floating money in the country, but the War Bonds maturing in two or three years, to some extent, did compete with them. That part of the floating money which was less liquid, was invested in the War Bonds, and therefore less was available for investment in Treasury Bills. In 1919-20, owing to the heavy cost of the Afghan War and the frontier operations, the Government had to fall back upon this resource, and could not carry out the net discharge of £8 million which the budget had contemplated.

(4) The Government of India obtained large funds from the expansion of the paper currency.

The Paper Currency in crores of Rupees.

		Total Circulation	Active circulation.
1914 1st February		63.9	51.9
1915 ,,	..	60.3	45.1
1916 ,,	..	62.4	54.1
1917 ,,		84.4	67.9
1918 ,,	..	104.8	82.1
1919 31st March	..	153.0	134.0
1920 ,,	..	174.0	154.0

Table 21.

N.B.—The active circulation = the total circulation—the notes in the Reserve Treasuries and the headquarter offices of the Presidency Banks.

This expansion of the paper currency proved very useful to the Government in its disbursements and was satisfactory so long as it could be freely converted into rupees at its face value, because it economised the use of silver for currency purposes. But, when the healthy expansion was transformed into a harmful inflation, making the conversion of notes into rupees difficult without an appreciable discount in the rural districts, and when the expansion was secured only by continually diminishing the metallic portion of the Paper Currency Reserve and increasing the portion invested in the British Treasury Bills, and at last by investing a part of it in the Treasury Bills of the Government of India itself, specially created for the purpose, the expansion became an undesirable feature of India's war finance.

(5) Another resource for the disbursements was the coinage of the silver remitted by the Secretary of State, and by the Government of the U. S. A. under a special agreement. That this proved to be a substantial resource is seen from the fact that the remittances of silver came to £19.5, 13.3, 56.3 and 22.7 million in 1916-17 and the three subsequent years respectively. The further expansion of this resource would have been desirable, because it would have enabled the Government to reduce its dependence upon the other unsatisfactory resources, and therefore it was unfortunate that the Secretary of State could not purchase and remit more silver than he did, on account of

the great demand for it and its consequent high prices. However, this resource would have been much less than it was, had it not been for the fact that in accordance with an agreement reached with the U. S. A. Government by a special mission, the Congress passed the Pittman Act, which allowed large quantities of silver dollars held by the Government in its treasury to be sold and sent to India.

(6) In 1916-17 a part of the Council drafts was paid from the Gold Standard Reserve in India and this was an additional assistance to the Treasury balances in India.

(7) The sale of reverse Council drafts in India in 1918-19 to support the exchange, which for a short time showed a tendency towards a fall, and in 1919-20 in the exceptional circumstances discussed later, also aided the balances in India.

While the Government of India had to make larger and larger payments in India, the Secretary of State obtained larger and larger payments. The problem for the Government in India was how to obtain funds to make disbursements, that for the Secretary of State was how to disburse the funds obtained. He secured large funds from the recoveries, chiefly from the Home Government, of the war disbursements made on its behalf in India and from the Council drafts, which had to be sold in response to the demands

of trade, although the sale became unnecessary so far as his requirements for the Home Charges and the capital expenditure were concerned. He therefore used the surplus of the funds in his hands over his requirements in assisting the Government of India, as far as he could, in its difficult task of making disbursements, and at the same time in assisting the Home Government in the prosecution of the war.* It has been explained above that the Government of India acquired a number of resources for its disbursements, and what the Secretary of State did with his surplus funds was to help it in acquiring them *i.e.* his part in England was complementary to that played by the Government in India. (1) and (2) Against the surpluses of revenues obtained by the Government of India in 1916-17 and 1917-18 and the issue of the Indian Treasury Bills in 1917-18, the Secretary of State invested £20 million in British Treasury Bills to provide for various liabilities which would have to be met by the Government of India on the return of peace. (3) While the Government of India obtained the use of large funds in the shape of the proceeds of the war loans floated for the purpose of assisting the Home Government in the conduct of the war, the Secretary of State made the corresponding sterling

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payments to the Home Government. (4) The Government of India could not issue currency notes without the backing of some sort of reserve. This reserve was supplied by the Secretary of State in the form of investments in the Home Treasury Bills. (5) He purchased and remitted to India as much silver as he could, so as to replenish the Government of India's stock of rupees, which was being continually depleted. (6) He added to the Gold Standard Reserve in London the amount, which the Government withdrew from the Reserve in India in 1916-17 for paying the Council Bills. (7) He paid the reverse Council drafts sold in India in 1918-19, and the succeeding year.

Side by side with this important part played by the Secretary of State in connection with India's war finance he gave valuable help to the Home Government in the prosecution of the war, firstly by discharging in 1915-16 and 1916-17 the temporary war debt raised in London in 1914-15, and by leaving the London loan market free to the Home Government by not indenting upon it any more, and secondly by lending large sums to the Home Government by means of investments in the British Treasury Bills, amounting to £ 67 million in 1918-19. Thus, a large part of the sums disbursed by the Government of India on behalf of the Home Government, and recovered from it, was lent back to it, and therfore, practically speaking, *during* the war period a large part of the sums

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disbursed by the Government of India for the Home Government was immediately as well as ultimately provided by the former. This was therefore one of the numerous services and sacrifices rendered by India in the cause of victory. It is true that this investment in the British Treasury Bills was not an out and out gift, like those of £ 100 million in 1917-18 and £ 45 million in 1918-19, and that the amount could be realised, when the financial position of the Home Government regained its stability after the return of peace—a part of it being actually realised in 1919-20—but it should be remembered that these war disbursements and investments were made only at the cost of serious trade restrictions and financial strain.

We may now proceed to examine the problem of the cash balances in India and England. Current expenditure on the revenue and capital accounts of the Government of India and the Provincial Governments, and also the expenditure of the local boards and municipalities, which keep their accounts with the Government, are met out of the balances in India, which include the deposits in the Postal Savings Banks. The expenditure incurred by the Secretary of State in England on behalf of the Government of India is met from the balances in London. Before the war, after a careful weighing of the annual financial requirements in India and England to be met from the cash balances, the Government declared that normally it was

unnecessary to close one financial year and begin another with more than £ 12.3 and 4 million of cash balances in India and England respectively and that in framing the annual budget, its policy would be to endeavour not to exceed these normal figures. However, the following figures show that the Government did not follow its own declared policy, for during the twelve years from 1908 to 1919, the closing balances exceeded the normal figures every year.

The Closing Cash Balances in India & England in £ million.

					Increase + or decrease— per cent over normal figures.		
		India	England	Total.	India	England	Total.
31 Mar.	1908	12.8	4.6	17.4	+5%	+25%	+10%
,,	1909	10.2	8.0	18.2	—19	+100	+10
,,	1910	12.3	12.8	25.1	— 3	+225	+53
,,	1911	13.6	16.7	30.3	+ 5	+325	+84
,,	1912	12.3	18.4	30.7	— 3	+350	+84
,,	1913	19.3	8.8	28.1	+54	+125	+71
,,	1914	15.6	8.1	23.7	+30	+100	+47
,,	1915	14.8	7.9	22.7	+22	+100	+41
,,	1916	12.0	7.0	19.0	— 3	+ 75	+16
,,	1917	15.3	5.4	20.7	+22	+ 25	+22
,,	1918	15.3	10.6	25.9	+22	+175	+59
,,	1919	17.3	14.7	32.0	+38	+125	+59

Table No. 22,

This continuous excess of the closing balances over the declared normal figures was the outcome, firstly of the large surplus of revenues resulting from their under-estimation, and secondly of the under-spending on capital account, not with any intention of achieving economy, but simply on account of the inability to spend. Most of this under-spending occurred in connection with the railway programmes. Every year a large budget provision was made

for carrying them out, large sums were borrowed, and when it was frequently found that the budget provision could not be fully utilised with profit and wisdom, the surplus went to swell the cash balances. Table 15 shows that this underspending continued during the war period, although to a much smaller extent. It will be seen that the balances in England sinned much more than those in India against the declared policy. The balances of the four years 1910 to 1913 were specially high, and gave rise to much adverse ciriticism. Consequently the Chamberlain Commission of 1913 among other matters, was asked to enquire into the location and management of the cash balances. The Commission came to the conclusion that the question of high closing balances was chiefly one of the estimation of the revenues, and admitted that cautious estimating was being carried further than was necessary. With regard to the balances in London, the Commission expressed the opinion that the India Office was open to the charge of being over-cautious in the renewal of debt.

During the war the maintenance of high balances against the declared intentions continued, and the war afforded better opportunities to the Finance Member for defending his action. During the first part of the war period, he maintained that the high balances were necessary, because they had to be widely dispersed in order to keep the treasuries and the savings banks well supplied with funds so as to enable them to meet the claims of

depositors or the demands for the encashment of currency notes without delay. During the second part, he defended the maintenance of the high balances on the ground that large war disbursements had to be made on behalf of the Home Government, and that the Government of India had ultimately to make good the sums which it had derived from the liquidation of enemy firms, and the employment of enemy vessels, and which it was temporarily using. Now, it was explained before, that these difficulties existed in India, and that resources were required to meet them in India; therefore these reasons cannot justify the maintenance of balances at a high level in England. Moreover, it is hard to know why the sums derived from the liquidation of the enemy firms and the employment of enemy vessels were not set aside from the high balances in England, where the Secretary of State had no Ways and Means difficulties. The Finance Member did not explain, why this was not done till 1919-20. As to the high balances in India, it must be admitted that the Ways and Means difficulties were real. But it has already been pointed out that the Government should have relied more than it did for meeting the temporary Ways and Means difficulties upon the temporary method of borrowing. Although the Chamberlain Commission in 1913 drew attention to the necessity of democratising the methods of borrowing, by the creation of new forms of securities and the extension of facilities, and made valuable practical suggestions, nothing was done till the middle of 1917. Moreover,

the Ways and Means difficulties should have been met to a larger extent by a larger import of gold than was actually done. In this connection the following figures are useful:—

The net import of gold during the war in £ million.*

U. S. A.	250
Spain	70
Holland	43
Denmark, Norway, & Sweden,	30
Switzerland	10
India	26
Japan and Argentina	57

Table 23.

These figures show that while the other countries with a total population of 170 million imported gold worth £460 million during the war, India, with a population nearly twice as large, had to be content with the import of gold worth £ 26 million only. Further, even granting the necessity of conserving the gold resources of the Empire for war purposes, it should be remembered that gold was wanted in India for the purchase of material essential for the prosecution of the war, and that therefore larger imports of gold would have quite accorded with the policy

* Swiss Bank Corporation's Financial and Commercial Review for 1919.

of utilising the gold resources of the Empire for war purposes. If this had been done, the demand for silver and the rise in its price would have been checked, and the Secretary of State's difficulties with regard to the purchase of silver would have been less embarrassing. Private import of gold might not have been quite desirable, but the Secretary of State with a part of the immense funds accumulating with him, could probably have remitted, without much difficulty, appreciable quantities of gold to the Government of India.

Coming to the location and the management of the cash balances and the loans from them to the Presidency Banks, one finds that the war forced the Government to alter its out-of-date policy in these matters, and to bring it more into harmony with the necessities of the time. To understand this it is necessary to go a little into history. In 1866 agreements were made with the Presidency Banks, by which a considerable portion of the balances was kept with them, and the remainder was kept in the district and sub-district treasuries. But in 1874 the Bank of Bombay was unable to let the Government draw upon its own balances kept with it, for the purchase of rice in Burma to relieve the scarcity in Bengal. This was due to the facts that the Bank had discounted a large number of bills, and that its capital as compared with the Government deposits in it was insufficient. The Government therefore decided in 1876 to keep only a small proportion of the

balances in the Presidency Banks. Of the remainder, that part, which was not held in the district and sub-district treasuries, was to be held in three reserve treasuries created for the purpose, as an independent reserve to be utilised in times of financial stress. The Secretary of State and the Government of India concurred in the view that artificial facilities to trade resulting from keeping large Government balances with the Presidency Banks were dangerous, and that capital supplied by the Government and not consisting of the people's savings was a resource, whose permanence could not be depended upon, but which led traders into dangerous transactions. The policy of the Government, therefore, inaugurated in 1876 and continued till the beginning of the war, was to keep only a small part of the balances with the Presidency Banks, and of the remainder to keep what was not required by the district and sub-district treasuries in the Reserve treasuries.

The Government of India thus maintained an independent treasury system, and with the exception of the U.S.A., was the only one among the prominent countries of the world to do so. Then, as regards temporary loans to the Presidency Banks from the cash balances, the Secretary of State decided that these loans should be granted only when the monetary stringency was specially acute, and to secure this, the loans were not to be made at a rate of interest below the current bank rate. The reasons given for this decision were that the trade should depend upon

its own resources, and that systematic loans from the balances during the busy season would reduce them below the minimum consistent with safety. The result was that in spite of the annual monetary stringency during the busy season, the Presidency Banks were generally unwilling to borrow from the Government at their bank rate, because they could not have obtained any remuneration from the work and risk involved in using the funds borrowed from the Government.

During the decade preceding the outbreak of the war, owing to the expansion of trade, the stringency in the money market during the busy agricultural season began to be felt more acutely than before, and this handicapped the trade expansion. The commercial community therefore endeavoured to induce the Government to increase its balances with the Presidency Banks, and to lend to them from the other balances during the period of the stringency at a rate lower than the bank rate. By this time, the old reasons for the strict policy in respect of the management of the cash balances had disappeared, and fresh considerations had arisen. Since 1876 the financial strength of the Presidency Banks had immensely increased, and the proportion of the Government to the private deposits was far less at that time than in 1876. Therefore, there was little fear that the Banks would not be able to pay the loans whenever required back by the Government. Again, it may be noted that the argument that trade should

not depend upon the Government balances, though valid in countries in which the movements of trade are on the whole spread evenly through the year, could not be upheld owing to the peculiarities of the situation in India. As her exports consisted almost wholly of raw materials, large funds were required during the harvest season for financing the exports, but it was during this time that large revenue payments were made, and that large amounts of the currency of the country were locked up in the Government independent treasuries, from which the disbursements were slack during this season, and became brisk when the agricultural season was over, and the money market having become easy, additional funds were not required. Moreover, the demands of the commercial community were most moderate. The suggestions were that loans should be made only during the period of the stringency at the absolute discretion of the Government, on first class security, from the unemployed balances in India, and from the funds, which had ultimately to be remitted to the Secretary of State, but which might be retained in India for a time. What the commercial community could not understand was the fact that, while the stringency in the money market was acute, the bank rate being as high as 9 per cent, and the Government of India declined to render any assistance, the Secretary of State lent large sums from his balances to financial houses in London at 3 per cent. The Government of India was on the whole, rather inclined to favour these proposals

of the commercial community, but the Secretary of State could not be persuaded and negatived them by repeating the old arguments.

What the insistent clamours of the commercial classes could not achieve, was secured to them by the war.

Cash Balances in India in Crores of rupees.

31st March	District and Sub-District Treasuries.	Head offices of the Presidency Banks.	Branches.	Reserve Treasuries.	Total.
Pre-war Average (1910-14)	9.42.43%	2.08.9%	2.81.13%	7.60.35%	21.19.100%
1915	10.17	2.62	3.33	6.05	22.17
1916	8.52	2.15	3.76	3.59	18.02
1917	8.26	5.95	4.17	4.56	22.94
1918	7.57	9.55	3.40	2.47	22.99
1919	7.25.28%	11.81.45%	3.33.13%	3.58.14%	25.99.100%
War average (1915-19)	8.35.37%	6.42.29%	3.60.16%	4.05.18%	22.44.100%
1920	7.72	13.66	3.54	1.55	26.47

Table 24.

It is thus seen that, while the proportion of the balances kept in the district and sub-district treasuries declined appreciably, and that of the balances in the Reserve treasuries was reduced considerably, the proportion of the balances kept with the head offices of the Presidency Banks increased immensely. Thus the lock-up of the funds in the reserve and other treasuries was largely avoided, and balances were kept with the Presidency Banks at all times considerably, and at certain times far, in excess of those maintained with them before the war. Moreover, the large proceeds of the war loans were kept in deposit with

them until they were actually required by the Government of India for the war disbursements. And lastly, temporary loans were made to the Presidency Banks from the balances on favourable terms. Thus, during the war period, a policy of a more liberal use of the Government funds to give relief to the commercial and financial interests in times of stringency was pursued. What was the cause of this remarkable change in the policy ? The war caused considerable strain upon the restricted Indian money market, and the strain was augmented by the Government's war finance, and there was a danger of a break-down if the pre-war policy of locking up a large portion of the country's funds into the Government treasuries, especially during the busy season, had been continued. If a financial collapse had occurred, all the efforts of the Government of India to assist the Home Government in the conduct of the war would have been largely frustrated, and the valuable assistance which India actually gave in various ways would have become impossible. The wonderful success of the war loans would have been impossible if the pre-war policy had been continued. These factors had to be taken into account by the Government, and the necessities of the war finance led it to introduce the welcome change in the policy regarding the management of the cash balances. It is true that a few months before he war, the Chamberlain Commission had recommended a more liberal policy in this connection, and that the Finance Member, in introducing the budget for 1914-15

had announced that the Government viewed the recommendation with favour, but it seems that but for the necessities of the war, the liberalisation of the policy regarding the cash balances would have been effected in a far less degree than was actually done. The effects of the change were entirely beneficial. The Government had not the slightest difficulty in using its balances, and at the same time the money market was relieved of much of the strain to which the Government war finance subjected it, and in particular it became possible to raise large sums by way of loans, without materially inconveniencing the market.

It now remains to consider briefly the prospects of the Ways and Means position. The difficulties, connected with the proper distribution of the Government resources between India and England, resulting from the enormous war disbursements in India, have mostly disappeared, but others, again the outcome of the war, have taken their place. One difficulty confronting the Government is the necessity of reducing its large floating debt in the shape of Treasury Bills, amounting to £ 35 million on 31st March 1920. For, whenever the money market becomes tight, the maturities tend to run off without being fully replaced by fresh sales of bills, and the Government has been continually under the apprehension that it may have to increase still further the fiduciary issue of notes in order to pay off the maturing bills. But the great

difficulty in the way of the reduction of this debt is the lack of surplus funds. The resources, which were built up in England during the war with great inconveniences and sacrifices by means of investments in the Home Treasury Bills at the rate of 1s. 4d. to the rupee, were largely brought back to India during 1919-20 at an exchange rate double the old one, by the sale of Reverse Councils, thus involving a very heavy loss. The Finance Member explained that this loss would be more than counter-balanced by the future reductions in the rupee cost of the Home Charges. But, while the loss has already taken place, the gain is distant and may be lost in the future, especially if the exchange value of the rupee being found too high, has to be fixed at a lower level. Moreover, whatever gain was secured in respect of the Home Charges in 1919-20, was utilised for railway capital expenditure and for meeting the deficiency in the Paper Currency Reserve, and the same procedure is contemplated next year also. The Finance Member has suggested that, in so far as the reduction of the floating debt is not effected by funding in long-term loans, the aim should be to utilise for this purpose any surpluses arising from the ordinary revenues. But this resource will require a long time to attain a sufficiently large magnitude, while it is essential that the floating debt should be considerably reduced as speedily as possible. It therefore appears desirable that the floating debt should be reduced by means of a part of the proceeds of loan operations and of the gain from exchange, which are being

devoted to railway capital expenditure and meeting the deficiency in the Paper Currency Reserve. The capital needs of the railways have been considerable, but they have been met so largely since the cessation of hostilities that they are less urgent now than the need for curtailing the floating debt. The redress of the deficiency in the Paper Currency Reserve is no doubt important, but it is also less urgent than the reduction of the floating debt. Therefore, both these objects can afford to be comparatively neglected for a couple of years, until the floating debt is substantially reduced, and the Ways and Means position is strengthened.

Another difficulty of the Government of India is that it is not able to borrow for capital expenditure the large amounts in the London money market that it did before the war, and will not be able to do so for some time, while its needs for capital expenditure have increased on account of the necessity of accelerating the pace of India's economic progress. The present shortage of capital in Europe owing to its immense destruction in the war is considerable, while the demand for it in the Western countries for purposes of reconstruction is large, and hence only a comparatively small part of the remaining capital of the London market will be available for India. This, however, need not be a cause for much anxiety, because the war has shown that the Indian money market can take the place of the London market to a large extent.

in meeting the capital requirements of the Government. The remarkable success of the Indian war loans revealed the increase in the strength of the Indian lending power, and so also did the loan operations of 1919-20, the actual proceeds of which, as explained before, considerably exceeded the budget estimate, in spite of the facts that at the time of the two war loan operations the Government had dipped deeply into the pockets of the investors, that no attempt was made to repeat the special propaganda associated with the two war loans, and that a very large number of company issues competed with the Government loan operations. Hence a much greater dependence may fairly be placed upon the Indian money market in future for raising the funds necessary for the development of the railways, irrigation and other productive works, than before the war, a change which is not likely to be regretted in the country. However, the Government will have to pay a substantially higher rate of interest in the near future, than before the war, as it has been borrowing heavily since 1917.

With regard to the balances, three reforms seem desirable, when the financial conditions become normal. In the first place, the practice of acquiring and keeping larger balances than the declared normal figure may be abandoned. As the Ways and Means difficulties resulting from the war disbursements have mostly disappeared, there seems to be no reason for continuing the practice.

This will be secured, if the revenues are estimated a little less cautiously in the budget, *in normal times*, and if the over-estimation of the practicable capital expenditure is avoided by carrying out the Chamberlain Commission's suggestion of a settled programme of railway development providing for three or four years in advance. Secondly, the normal figure of £. 12 million, to which the balances in India should approximate as closely as possible, probably requires to be cut down. The Chamberlain Commission in 1913 expressed the opinion, that "If the Government could count on raising larger sums each summer in permanent loans, it should be possible for them to reduce to an equivalent extent their estimate of £ 12 million as the amount of the closing balance required on March 31st to tide over their summer and autumn requirements." It has been mentioned above that it is possible now to raise much larger sums in permenent loans every year than before the war, and this should render possible a corresponding reduction in the normal figure of the Indian cash balances. Thirdly, the present independent treasury system is wasteful and is contrary to the pratice of all the prominent countries, with the exception of the U.S.A. Even there, the establishment of the Federal Reserve Board has brought about most important alterations in the system, and may lead to its abolition. The system locks up the funds of a country and renders them inaccessible to the public for their commercial needs. Under it, the financial structures of the Government and of the commercial and industria

community, remain independent, instead of being joined together by means of a national bank. If India's industrial and commercial advance is not to be handicapped, it is necessary that her independent treasury system should be gradually abolished by the establishment and the development of a national bank, which should gradually establish branches all over the country. Therefore, the decision to create the Imperial Bank of India by the amalgamation of the Presidency Banks, and gradually to transfer the Government balances to its branches from the independent treasuries, is of a very hopeful augury for the future.

During the war as explained above, the Provincial Governments had to practice strict economy and consequently their balances with the Central Government increased considerably. In the budget of 1919-20 these Governments were allowed to draw upon them to the extent of £1½ million, but they were left untouched owing to the increase in the provincial revenues. The Governments should now frame well-conceived programmes of expansion in such beneficial services as education, sanitation and medical relief, and should finance them during the next few years by drawing upon their accumulated balances.

CHAPTER VI.

Taxation and Expenditure.

In the modern public finance of advanced countries, the burden of taxation is regulated by the expenditure which is considered necessary, instead of expenditure being made to depend upon the revenues. This principle, however, is subject to the qualification that schemes requiring an increased expenditure cannot be undertaken without a careful attention to the feasibility of raising the additional revenues required by means of higher taxation. The revenues that can be raised by means of taxation are obviously limited. This limit, however, is elastic, and varies with the peculiarities of prevalent conditions. The necessities of a war, for instance, may become paramount, and if the expenditure on its prosecution must be borne under any circumstances, it has to be met largely by means of higher taxation. The war remarkably exemplified the elasticity of the limit to the increase of taxation or, in other words, the possibilities of the expansion of direct taxation, in the western belligerent countries, especially in England and Germany, where, with the progress of the war, larger and larger revenues were raised by means of higher and higher taxation. The case of India, however, was quite different. While the former were prosperous manufacturing countries, the latter

was a poor agricultural country. The poverty of India has been universally acknowledged, and the best proof of it is that before the war even the official estimate of its income per head of population did not exceed £ 2 as against £40 in England. This difference was recognised by the Government of India also, which pointed out that "There are rigid limits to the taxable capacity of India, leaving out of consideration the fact that three-fourths of the population depends upon agriculture, and hence upon the incidence of the monsoon for its means of livelihood. As a result of these two factors, the expansion of direct taxation, a primary element in the war finance of Great Britain and her Dominions, has been very difficult in India"* It would not therefore be fair to compare India's war taxation *as a whole* with that of the Western countries, and to draw a conclusion unfavourable to the former, because the conditions were quite different, and there was no common basis for comparison. The war taxation of the richer classes in India, however, may be compared with that of similar classes in the other countries, merely in order to ascertain in a rough way, the extent of the severity of the increase in the burden upon the former, because the conditions of the richer sections of the community in India and the other countries were somewhat similar. However, care must be taken not to attach an undue importance to this sort of comparison, because the dissimilarities of the

* Statement exhibiting the Moral and Material Progress of India in 1917-18, p. 15. See also Appendix 2.

conditions were hardly less marked than the similarities Moreover, in examining India's war taxation, in addition to this special factor of the inelasticity of the limit of India's taxable capacity, another general factor, applicable to all countries, must be taken into consideration, namely that an increase in taxation can be defended only if it can be proved that the increase in expenditure was absolutely necessary, that it could not be met from the then existing revenues, or in any other way, and that the increased taxation did not impose an undue and unnecessary hardship upon the mass of the population.

The war converted the budgeted Central surplus of £ 1.2 million for 1914-15 into a deficit of £ 1.8 million, and in the budget for 1915-16, a deficit of £ 2.8 million was anticipated. It was decided to meet these deficits by temporary borrowing, and no additional taxation was resorted to. Under the circumstances prevailing at the time, this decision appears to have been wise. In the first place, the deficits were the products of special and temporary circumstances, while ordinarily the Government secured large surpluses. During the first year of the war it was generally expected that the struggle would be a short one, and therefore the Finance Member could not disregard the possibility of an early improvement in the finances. Secondly, as regards the Ways and Means, in spite of the deficits, he saw his way to finance all the

necessary outlay, and with an early cessation of the hostilities, the return of a large portion of the deposits withdrawn from the postal savings banks was expected, as also an expansion of the note issue, from the restoration of the public confidence. Thirdly, the population was seriously affected by the trade depression and dislocation, and by the rise in the prices of the necessaries of life at the beginning of the war, and an increase in the burden of taxation, in addition to a probable failure to raise the required revenues, would have caused discontent, which, above all, it was necessary to avoid at that time. Fourthly, the increase of taxation, even if successful at the time, would have been shortsighted, because the exhaustion of the taxable capacity of the population in the early stages of the war would have rendered it impossible for the Government to secure more revenues later on, when it might have become absolutely essential to obtain them. Although an early termination of the hostilities was expected, it would have been imprudent to count upon it, and it was highly desirable to husband the resources in the shape of the revenues from higher taxation. Lastly, the recourse to borrowing for meeting the deficits would not have penalised the future Government of the country, because the borrowing was only temporary, and was to be repaid in a short time. And even if it had involved an increase in the funded debt, it should be remembered that India's unproductive public debt was small at that time.

In the budget for 1916-17, however, it was decided to obtain larger revenues from the customs and the consequential changes in the excise duties on liquors, an increase of the income-tax and an enhancement of the salt duty. The general import tariff since 1894 had been at the rate of 5 per cent ad valorem. It was now raised to 7½ per cent ad valorem, except in the case of sugar, the import duty on which was raised to 10 per cent, because it was thought that this would not inflict any real hardship on the consumer, on account of the large imports of the article and India's facilities for internal supply. This was true, and in addition, the duty afforded a stimulus to the Indian sugar industry. Secondly, the list of articles free from duty was materially curtailed, but some of the articles withdrawn from the list were to pay a duty of 2½ per cent only. Thirdly, the special rates of duty charged upon the import of certain articles, such as arms, liquor and tobacco, were raised. Fourthly, the duty of 3½ per cent on the import of cotton manufactures was left unchanged. Since 1896 the import of cotton twists and yarns had been free of duty, while a duty of 3½ per cent had been imposed on woven goods of all kinds, whether imported or manufactured in Indian mills. This position was left untouched. Lastly, an export duty on two important staples, tea and jute, was imposed. That on tea was at the rate of Rs. 1½ per 100 lbs, that on raw jute was Rs. 2¼ per bale of 400 lbs, and those on manufactured jute sackings and hessians were Rs. 10 and 16 per ton respectively.

Now, granting for the moment, the necessity of an additional taxation, the merits of these changes may be considered. The reduction in the import of sugar during the war stimulated the Indian sugar industry, as shown by the considerable increase in the area under sugar-cane cultivation, but the decrease in the import appears to have been due much more to war conditions than to the imposition of the import duty. The export duties on tea and jute were satisfactory, as both these industries were specially prosperous during the war. Further, jute could well bear this duty on account of the fact that India possesses a monopoly in this product. The case of tea was hardly less strong, especially because the tea business, in spite of its industrial character, had been exempt from the income-tax. The decision to leave the position of the cotton manufactures unchanged gave rise to a long public controversy. Before 1882, there was a small import duty for revenue purposes on all imported goods. The establishment of cotton factories in India in 1877 led the House of Commons to pass a resolution to the effect that "In the opinion of this House, the duties now levied upon the cotton manufactures imported into India, being protective in their nature, are contrary to sound commercial policy and should be repealed without delay". Another similar resolution was passed in 1879, and in 1882 all import duties, including those on piecegoods, were abolished, although Indian finances were not in a satisfactory condition owing to the Afghan war and the effects of a severe famine. In

1896, the state of Indian finances rendered it necessary to re-impose the import duties, and the Secretary of State, as a result of the pressure exerted by the House of Commons, levied a countervailing excise duty of $3\frac{1}{2}$ per cent on all cloth manufactured in India by steam power. This excise duty was unpopular, and in the opinion of most textile experts, was an appreciable handicap upon the progress of the industry.

This position continued till 1916, when as mentioned above, although the import duties were raised in all other directions, the duty on cotton goods was left alone. The question naturally arose, why this was done at a time, when, in the opinion of the Government, fiscal necessities compelled it to make a material enhancement of the tariff in nearly every other direction. The Finance Member explained that the Government of India had not failed to represent its view that the import duties on cotton goods also should be substantially raised, while the cotton excise duties should be left alone, and should be abolished, when financial circumstances became more favourable. But His Majesty's Government replied that, "the raising of this question at the present time would be most unfortunate, as it would provoke a revival of old controversies, at a time when they specially desired to avoid all contentious questions both in India and England, and might prejudice the ultimate settlement of the larger issues raised by the war. His Majesty's Government feel that the fiscal relationship

of all parts of the Empire as between one another and the rest of the world must be reconsidered after the war, and they desire to leave the question raised by the cotton duties to be considered then, in connection with the general fiscal policy, which may be thought best for the Empire, and the share, military and financial, that has been taken by India in the present struggle."

Let us now turn to the question whether the increase of taxation in 1916-17 was necessary. The Finance Member gave several reasons to defend the increase. Firstly, he had to assume that the war would continue for a year more, perhaps longer, and he could not go on, year after year, with uncovered deficits. Secondly, the Secretary of State was unable to borrow substantial sums in the London money market, while the lending capacity of the Indian money market was limited. Thirdly, the end of the war would leave the Government of India with heavy financial responsibilities. A large amount of temporary debt would have to be paid off, the experiences and lessons of the war must add to the permanent military charges, and larger funds would have to be provided for such beneficent purposes as the improvement of education and sanitation. There seems to be much force in the first argument and therefore the necessity of the increase of taxation may be granted. However, with ragard to the second, it has been already pointed out that the marvellous success of the war loans in 1917-18 and 1918-19

showed that if the Finance Member had given up his doubts, and had floated a big loan in 1916-17 along the lines pursued in the two subsequent years, in all probability, he would not have been disappointed. As regards the third argument, it may be noticed that the temporary debt at this date amounted to £ 10 million only, and that, as the Indian revenues had already begun to show substantial strength and recuperative power, it would not have been difficult to pay off the temporary debt soon after the termination of the war. In respect of the increase of the permanent military charges, it has been explained that, as, before the war, India bore a large burden of military expenditure, which was being appreciably increased during the war, it would have been probably unnecessary to increase that burden after the war.

At this stage, the question arises, which of the two alternatives, borrowing or additional taxation, was preferable for meeting the war expenditure. A misconception regarding this question seems to prevail in the popular mind. It seems to be generally thought that, in so far as the expenses of a war are met by means of higher taxation, its burden falls upon the generation which prosecutes it, but that, in so far as the expenses are met by means of floating long-term loans, the burden is shifted to later generations. This notion appears to be at the bottom of the general desire that at least a substantial part of the

expenses of a war should be met by means of long-term loans, because the later generations also are supposed to benefit from the advantages that may result from the war. This idea, however, appears to be incorrect so far as internal loans are concerned. A war can be fought only with the goods and services of the generation which conducts it, all that internal loans can do is to give to the government of a country the command over a portion of these goods and services, and it is impossible to obtain command by any means over the goods and services of later generations for the purpose of conducting the war, simply because they do not exist. The only effect of such internal loans is to make the distribution of wealth among the several classes of the existing generation and among those of the succeeding generations somewhat different from what it would be if the war is financed entirely by means of higher taxation. Only to the extent that a country can finance a war by means of long-term external loans *i. e.* loans raised and expended by it in other countries, is it enabled to throw its burden upon the following generations, because to that extent the goods and services are borrowed from the existing generation of other countries, and will have to be repaid to their later generations by the corresponding generations of the borrowing country. This is what would happen if the loans granted by the U. S. A. to the United Kingdom, France and Italy during the late war are funded into long-term loans. However, it is evident that a country can meet only a small part of its war expenses

in this way, that for the remainder it has to depend entirely upon its own existing resources, and that it cannot obtain the resources of later generations for this purpose. Similarly the burden of the loans raised in India to assist the Home Government in the conduct of the last war must fall upon its existing generation, because the loans were expended upon the purchase of Indian goods and services. Thus, whether a war is financed by means of an increase in taxation, or by means of long-term internal loans, its burden must fall upon the generation which conducts it, and from the pure economic point of view the former alternative seems preferable, because it makes the full extent of the burden clear to all and assists the economic process of the proper adjustment between production and consumption. But politicians maintain that from the point of view of practical politics, it is an advantage that the expedient of long-term loans for financing a war largely conceals its burden for the existing generation, and that it is essential to finance any war to a large extent in this way, because, if the whole burden were to become plain to the people, they would be discouraged and even discontented, and the government would lose their supoport in the conduct of the war. The financing of a war by inflating the currency has a similar effect of concealing a large part of the real burden. It is not the function of an economist to pronounce judgment upon this political view, but it seems necessary to point out that, if it was found essential even in the Western countries to finance the late war to a large

extent by means of loans, it follows that it was still more necessary to do so in India, where the public sense was far less developed. However, the desirability of financing a war by increasing the rates of taxation as far as this can be done without causing considerable discontent and losing the support of the people, has been recognised by most politicians. Therefore, no exception can be taken to the increase in the income-tax in India in 1916-17, because the burden was imposed upon the shoulders best able to bear it. Under the system of taxation existing till 1916-17, the public burden was not quite equitably distributed, and it cannot be said that the richer classes were contributing their proper share to the national expenditure, especially as compared with their equals in other countries such as England and Germany, in which they sustained a much larger part of the burden of taxation, which became far higher with the progress of the war.* The richer classes might perhaps have welcomed borrowing by the Government in preference to an increase of taxation falling upon them, but it could not have been a wise policy. Till 1916-17, all incomes, excepting those derived from agriculture and religious and charitable property, which were free from tax, above Rs. 1,000 per annum were subject to an income tax. A distinction, however, was made between the profits of companies and the interest on securities, on the one hand, and the incomes from other unexempted sources, on the

* See Appendix 3.

other. The latter, if between Rs. 1,000 and 2,000 per annum, paid 4 pies in the rupee, and if above, 5 pies. The former paid uniformly 5 pies in the rupee. Therefore, the normal income tax rate was 5 pies in the rupee, which was about equivalent to 6d. in the pound. In 1916-17 all the then existing exemptions were left untouched, and no alteration was made in the taxation of incomes below Rs. 5,000 per annum. But incomes from Rs. 5,000 to 10,000, 10,000 to 25 thousand, and above 25 thousand were henceforth to pay 6 pies, 9 pies and 1 anna in the rupee, *i.e.* $7\frac{1}{2}$d, $11\frac{1}{4}$d., and 1s. 3d. in the pound respectively. The profits of companies and the interest on securities were to be assessed at the 1 anna rate, but this was to be subject to an abatement or exemption to individual shareholders or security holders, who could show that their total income was such as to warrant a lower rate of taxation or none at all. The principle of graduation was thus introduced in the Indian tax system for the first time.

These rates compared very favourably with those of the English income tax. Just before the war, the latter, leaving apart the super-tax introduced in 1910, ranged from 9d. to 1s. 3d. in the pound. These were doubled after the outbreak of the war, and in 1915 there was a further increase of 40 per cent on the previously doubled rate, while the limit of exemptions and the scale of abatements were lowered. The English income tax therefore at the beginning of 1916-17, leaving aside the super-tax, was from

2s. 1d. to 3s. 6d. in the pound. The difference between the English and Indian rates was marked. Hence, it is obvious that the Indian rate prior to the increase in 1916-17 was low, and that if the Government thought it necessary to increase taxation and even to hit the poor by raising the salt duty, it would have been unjust not to obtain more revenues from the richer classes. Even after the increase in the income-tax, it was calculated that out of the total number of assesses of 332,000, the increase would affect only 37,000, who were well-to-do, and that, even in their cases, the increase as compared with that in England, was far from burdensome.

It is, however, difficult to support the increase in the salt duty from Re. 1 to Re. 1¼ per maund. The Finance Member explained that an enhancement of the salt duty had always been considered as a reserve to be drawn upon in times of war or other financial calamities. He, however, admitted that the duty would have to be largely paid by the poorer classes. It appears that there were a number of objections to the increase. In the first place, the reserve should have been tapped, only when it was absolutely necessary, especially, as the incidence of the tax fell largely upon the poor. This seems to have been hardly the case, because the duty was increased not to cover any deficit, but merely to increase the under-estimated surplus of £ 0.4 million, after taking into account the increase in the income-tax and Customs duties, to £ 1

million. Secondly, the past experience had shown that even small increases and decreases in the duty caused a considerable dislocation in the retail price of salt, and that the actual rates charged to the consumers were considerably higher than the increase in the revenues secured by the Government. It would therefore have been better not to have increased the duty until a permanent necessity arose for larger revenues for the purposes of the administration, and then so to regulate the duty, that it might be kept at that rate for a number of years. Thirdly, all the resources of the Government were hardly so exhausted that it should have found the recourse to an increase of the salt duty essential, which would have hit hard the poorer classes who were already affected by the high prices. It is doubtful whether it was impossible to find out other and better ways of raising the additional revenues expected from the enhanced salt duty, if it was felt that they were quite necessary. For instance, a higher duty on the export of jute could have been levied with advantage, as it could have borne a higher burden without difficulty, on account of its monopolistic position.

In the budget of 1917-18, the Government decided to make a gift of £ 100 million to His Majesty's Government for the prosecution of the war. This imposed an annual burden of £ 6 million for interest and sinking fund charges and converted the estimated surplus of £ 2.7 million for 1917-18 into an estimated deficit of £ 3.3 million

Additional taxation therefore became necessary, and the Government had to decide what form it should take. The Finance Member explained that an easy way of raising fresh revenues would have been to increase further the salt duty, and that it would have been suitable because the lower classes could not stand aside in the matter of rendering financial assistance for the conduct of the war. The Government, however, decided not to resort to this expedient, because, since the enhancement of the duty in the previous year, the price of salt had much increased. This decision was praiseworthy, and was partially the result of the general opposition to the increase of the duty in 1916-1917. The burden of taxation upon the mass of the population was already heavy enough, the sacrifices which they were making in the shape of the high prices were by no means light, and a further enhancement of the salt duty would have been very unpopular. Then a special cess upon land was suggested to the Government, which, however, declined to accept the suggestion on the ground that as far as possible the imposition of special cesses upon land should be left to the local bodies to help them in meeting their growing financial needs, in respect of local communications, sanitation and medical relief. No exception can be taken to this decision also

The same judgment, however, cannot be passed on the decision to refrain from levying an excess-profits tax, and to impose a super-tax instead, on the grounds that

the Government did not possess the elaborate income tax machinery required for determining normal profits and excess gains in different trades, and that an excess-profit tax could only be a temporary measure. The plea of the lack of the necessary income-tax machinery crumbles away, when it is pointed out that it did not prevent the Government from imposing the tax in 1919-20. What could be done in 1919-20, could probably have been done in 1917-18, and with much greater advantage. It would not have been difficult for the Government of India to import from England in 1917 an expert official thoroughly familiar with the working of the excess-profits tax in England, and to organise the necessary machinery with his assistance. Then, as to the temporary nature of the excess-profits tax, it should have been levied first, and when it disappeared after the end of the war, the super-tax could have taken its place. This would have been a fairer and more profitable arrangement. From 1916, the commercial and industrial classes in the capital cities were making larger and larger profits, far larger than their pre-war profits and the taxation of these excess profits would have brought in a large sum. The super-tax had the effect of exempting the greater portion of these profits, and thus of throwing a large part of the burden on those individuals who had not in any way profited by the war. It is difficult to understand why the Goverment, while closely following the principles of obtaining money, which prevailed in England, should have departed from them in this one respect

Having rejected these suggestions, the Government decided to raise the necessary sum by means of a super-tax on large incomes in addition to the ordinary income tax, raising the import duty on cotton goods from 3½ to 7½ per cent and the export duty on jute, and a surcharge on railway goods traffic. The super-tax was imposed on incomes exceeding Rs. 50,000, and at a progressive rate in the following manner :

For incomes between Rs. 50,000 and 1 lakh	1 anna per rupee.
For incomes between Rs. 1 lakh and 1½ lakhs	1½ ,,
For incomes between Rs. 1½ lakhs and 2 lakhs	2 ,,
For incomes between 2 lakhs and 2½ lakhs.	2½ ,,
Over 2½ lakhs	3 ,,

These rates were in addition to the ordinary income tax of 1 anna in the rupee, so that a person having an annual income exceeding Rs. 2½ lakhs had to pay 4 annas per rupee on that excess, equivalent to 5s. in the pound. His position was thus more favourable than that of the wealthy taxpapyer in England, who by this time had to pay an income tax of 5s. in the pound, while the super-tax extended up to [illegible]s. [illegible]d. in the pound. The next source, from which additional revenues were raised, was the export duty on jute. The rates of the previous year were now doubled, and considering India's monopolistic position

in jute production, which enabled taxation to be passed on to the consumer, no objection could be raised against the increase.

The ground, on which the Home Government declined to allow the Government of India in 1916 to include cotton goods in the list of articles subjected to higher import duties for revenue purposes, was explained above. But now, the Home Government gave its consent to the Government of India's renewed proposal to be allowed to raise the import duty on cotton goods from $3\frac{1}{2}$ to $7\frac{1}{2}$ per cent, the general tariff rate, the cotton excise duty remaining at $3\frac{1}{2}$ per cent as before, on the ground that India's war contribution must be worthy of her and of the place which she desired to hold in the Empire. Some members of the House of Commons demanded that, if imported cotton goods were made to pay a duty of $7\frac{1}{2}$ per cent, Indian cloth should pay the same. The Home Government declined to accede to this demand, but yielded so far as to promise that the question should be reconsidered after the end of the war. The view of the Government of India regarding the excise duty was, that it should be abolished when the financial circumstances became more favourable, but that there could be no question of removing it at a time when fresh taxation had to be imposed. Finally, a surcharge on railway goods traffic was imposed at the rate of one pie per maund on coal, coke and firewood, and two pies per maund on other articles. Although the rate was low,

this kind of taxation was not quite desirable, because it had the effect of adding one more obstacle to those already existing in the way of the growth of commerce and industry. In addition to this fourfold increase of taxation, larger revenues were secured by increasing the railway fares and the telegram charges, and this virtually constituted increased taxation.

The year 1917-18 yielded a large surplus of £ 8 million, the budget estimate of the surplus for 1918-19 was £ 2.3 million, and as the difficulties existed on the ways and means, and not on the revenue, side, there was no necessity to add to the new taxes levied during the two previous years. On the other hand, no exception could be taken to the Finance Member's view that, while the war continued, there could be no question of reducing the level of taxation.

In 1919-20, however, there was a further increase of taxation in the shape of the levy of an excess-profits tax. In September 1918, the Government of India decided to make a further gift of £ 45 million to the Home Government, in addition to that of £ 100 million in 1917-18, by taking over the charges of a large number of troops. The charges were estimated to amount to £ 12.7 million in 1918-19, to £ 14.7 million in 1919-20, and if the war then ended, to £ 7.7 million in 1920-21, the period of demobilisation. The hostilities happily ceased before this estimated

period, so that the second instalment of the gift disappeared, and in 1919-20, apart from the running pension charges, only the third instalment amounting to £ 8.7 million had to be paid. The budget estimate of the excess of the current revenue over the expenditure was £ 3.7 million, out of which £ .7 million were set aside as a margin against the fluctuations of the year, so that only £ 3 million were available for paying the last instalment. It was decided to make up the shortage of £ 5.7 million by levying a duty of 50 per cent on excess profits. It was applied to all businesses, which in 1918-19 made a return of profits exceeding Rs. 30,000, with the exceptions of agriculture, salaried and professional employments depending upon personal skill, and concerns already paying the duty in England. Excess profits were defined as the difference between the profits returned in 1918-19 and the average of the profits returned in the two pre-war years and the first two years of the war, for income-tax purposes, and the Government took half the excess. If any business did not pay the income tax in these four years, its excess-profits were assumed to be the amount by which its actual profits in 1918-19 exceeded 10 per cent of its capital.

Now, as to the necessity of the levy. If it be granted that it was necessary to pay the last instalment of the second direct war gift, there can be no doubt that the levy of an excess profits duty was the best means of raising the required sum. The alternative suggested by some

representatives of the commercial community, *viz.* an amendment of the super-tax system, which would allow that tax to be assessed on the whole profits of companies instead of their undistributed profits only, was not acceptable. In the first place, it would have entailed a higher scale of assessment, and would have penalised the shareholders of those companies, which made no extra profits during the war, to the benefit of the shareholders of those, which made huge war profits. Few, if any, will deny the justice of the principle that those, who made exceptional profits from the circumstances of the war, should contribute a portion of them to the cost of the war. Secondly, the higher scale of assessment would have become unnecessary on the return of more normal times, but the Finance Minister, having secured such a scale, like his fellows in all countries, would have been tempted to adhere to it, even after the necessity for it had passed away. The super-tax was likely to become a permanent feature of the Indian tax system, while the excess-profits tax was only a temporary war measure.

In the budget for 1920-21, the burden of the excess-profits duty upon industry was removed. This was accompanied by a modification in the super-tax. The super-tax on the undivided profits of companies and firms, as it existed then, had been adversely criticised on the grounds that it gave an incentive to companies to distribute more in dividends than was warranted by their real financia

pos'tion, and that it penalised those companies which endeavoured to strengthen their reserves. It was urged that the Government should have levied the tax at a moderate rate on the whole income of companies instead of applying the higher tax to their undivided profits. The Government, therefore, now relieved the undivided profits of companies and firms, of the super-tax which ran up to three annas in the rupee, and replaced it by a new form of the super-tax, consisting of a flat rate of one anna in the rupee, assessed upon the total income of each company in excess of Rs. 50,000. This was to be in addition to the ordinary tax, as before. The super-tax on individual incomes remained unchanged.

The results of India's war taxation may now be summed up. In the first place, the larger part of the extra expenditure involved by the war was met by higher taxation and the smaller part by means of loans. As explained above, the real burden of the war upon the present population of the country as a whole would not have been greater, even if its expenses had been met entirely by a further increase in taxation. But, for the reasons explained before, the Government seems to have thought that it was not possible to meet more of the war expenditure in this way, than was actually done, without creating a feeling of severe and unfair hardship in the country. In the second place, the war taxation made the incidence of the Indian system of taxation fairer than before the

war. In pre-war times the richer classes did not contribute their fair share to the state expenditure. The bulk of the burden of the land revenue, excise, salt and customs duties was borne by the poorer clsses, and the income-tax, with a low and flat rate, was the only impost, which somewhat restored the balance between the upper and lower classes of the community. The war did this to a much larger extent. The burden upon the poor classes was no doubt increased, but that upon the wealthy sections of the community was increased to a much greater extent. A graduated scale was introduced in the income-tax, large incomes were subjected to a graduated super-tax, and a part of the exceptional war profits was taken away, although very late, by means of the excess-profit duty. It had been recognised in the advanced countries, especially in England, even before the war, that taxation in proportion to income did not involve an equality of sacrifice, and that the capacity to pay taxes increased more than in proportion to the increase in incomes, and this realisation had considerably affected their systems of taxation. It is true that the Indian system would have been similarly affected, even if there had been no war, but the progress in this direction would have been very slow and halting. The process was much hastened by the war, and there can be no doubt that it has come to stay. Thirdly, the addition to the burden of taxation resulting from the war, with the exception of the increase in the salt duty, did not impose any severe hardship upon the bulk of the population.

Large sums were obtained by means of the increase in the income tax, and of the super-tax and excess-profits tax but they were contributed by those sections of the community, which were best able to bear the addition to the burden of taxation, and which, on the whole, were less burdened than similar sections in the prominent belligerent countries. The jute and the tea industries on the whole prospered during the war, and the export duties on them did not affect them adversely. The increase in the customs duties had no material effect upon the necessaries of life of the masses. But, the enhancement of the salt duty did impose a considerable hardship upon them, as shown by the abnormal rise in the price of this neccessity of life. The surcharge on railway goods traffic also was an unfavourable factor in the development of Indian industries, at a time when they urgently needed every possible encouragement. These two imposts therefore should have been avoided, and the sums obtained from them could probably have been secured in other and more advantageous ways. However, any conclusion, from the above statement that the war taxation on the whole did not impose severe hardships upon the masses, to the effect that India escaped lightly from the burdens of the war, would be inconsistent with the actual facts. The burden of the war taxation was not very severe, and could not be so, because the indirect burdens of the war were far heavier than the direct burden of taxation. In an estimate of the part played by India in the war, both

kinds of burdens must be taken into account, and the conclusion after the perusal of the next chapter will be inevitable that India rendered more sacrifices in the cause of victory than she could fairly have been expected to do.

The prospects of the Indian tax system may now be briefly considered. The great question is whether some relief from the present scale of taxation may be expected in the near future. To this question, the prospects of the public expenditure examined before give a negative answer. The need of reducing the military expenditure and the cost of the administration, which, especially the former, increased very considerably during the war, was explained before. But, even if this retrenchment is carried out, India's public expenditure will go on increasing, because the need of promoting the social and economic development of the country is most urgent. To provide the facilities of primary education for 315 millions of souls, to enable them to escape the clutches of preventible disease and to combat successfully unavoidable disease, and to assist them in procuring the means of a decent standard of comfort fit for civilised life, are tasks requiring vast sums. To obtain these, the present level of taxation will not only have to be kept up, but will have to be raised higher. However, it is clear that most of the increase in the burden will have to be imposed upon the richer classes which before the war contributed much less than their

fair share to the revenues, and which, although contributing a larger share now, can hardly be said to be bearing their proper share of the burden, as compared with their equals in the advanced countries. One of the effects of the war has been the triumph of the principle of graduation in the tax systems of the advanced countries, and it is bound to produce a similar effect upon the Indian system. Therefore the present rates of the income tax and the super-tax will have to remain, while the Government will in the future have to rely largely on the levy of an inheritance tax or death duty, imposed upon personal as well as real property above a certain value, and graduated on an economic scale. Proper safeguards will have to be introduced in order to restrict a transfer of real property during life, by gift or by collusive sales. This tax may be upheld on economic and fiscal grounds,* and its success in the western countries, particularly in the United Kingdom, shows the desirability of its introduction in India in preference to other new taxes and to any increase in most of the existing taxes. However, it is open to two main objections. In the first place, it may be urged that the inheritor, if a Hindu, will have to perform the funeral ceremonies of the person, from whom he inherits, and will have to support the members of the joint family. It may however, be answered that in any case he has to bear these liabilities either by law or custom. Secondly, it may be

* Cf. for instance, Seligman, Essays in Taxation, pp. 121 ff., and Cohn, Science of Finance, p. 357 and pp. 560-1.

objected that in the case of inherited landed property, it may sometimes be impossible to raise the amount necessary for the payment of the tax, except by selling or mortgaging the property at a heavy loss. The solution of this difficulty would appear to be in allowing the tax to be paid in instalments extending over a sufficiently long period.

The necessities of expenditure will not allow a reduction in the burden upon the masses, except in so far as it presses unduly upon them. The increase in the salt duty appears to be such an exception, and it should be reduced to its pre-war level as soon as possible. Further, it will not be desirable to increase the burden upon the masses in the near future. On the one hand, to place a heavy burden of taxation upon them, and, on the other, to endeavour to ameliorate their condition, are inconsistent policies. The war has accelerated in the western countries the pre-war pace of the growing taxation of the richer sections of the community for the promotion of the welfare of the community as a whole, and the Indian tax system will be silmilarly affected in the near future, although at a a slower rate.

Finally, it seems that in time the Indian system will be mostly based on the principle of direct taxation. However, it should be noted that direct taxation has always been unpopular in every country, where the public sense is more

or less rudimentary. But, when the sense of a citizen's duty towards the state grows in a country, it becomes evident to all that the most scientific and the fairst method of taxation is direct taxation. This fact is not yet generally recognised in India, where all sorts of indirect imposts on land, excisable goods and the products of industry are preferred to direct taxes, simply because the burden is not so obvious. It escapes notice that one result of the indirect methods of taxation is to limit the spending power of small incomes in a much greater degree than the direct taxes on income would do, at the same time assisting the perpetuation of the anomaly, whereby a few huge fortunes bear an absurdly small proportion of the communal burden of taxation. Since, however, there is in India a strong prejudice against direct taxation, it will be simpler and more politic to continue for the present along the traditional paths, and to wait for the growth of the public opinion that only by direct means can justice in taxation be assured.

CHAPTER VII.

Contributions to the War and Public Debt.

India's financial and commercial position during the war was profoundly affected by her numerous sacrifices, direct and indirect, financial and military, and as it is not possible to obtain an adequate picture of that position without realising the full extent of the sacrifices, it appears essential to examine and analyse them briefly.

On the outbreak of the war, both France and England were quite unprepared, and the irresistible tide of the German armies came rushing forward. At this critical time, well-trained Indian regiments were hurried across the seas and thrown into the breach, and helped to stem the tide. All military experts are unanimous in the opinion that the German rush to Paris could not have been checked without these gallant regiments, which in a few months were almost wiped out, fighting bravely in the terrible cold of the winter, which they had never known before. India was able to send them to the battlefields at a moment's notice, only becuase, for many years past, she had been bearing a heavy expenditure for a large army maintained for her own defence as well as that of the Empire as a whole. Having sent these regiments, the Government of India desired to continue to pay their expenses. But the Government of India Act prohibited the use of Indian revenues for paying the expenses of any military

operations carried on beyond India's frontiers, except for repelling an actual invasion, without the special consent of Parliament. The Government of India applied for such a sanction, and Parliament passed a resolution allowing it to bear only the normal charges of the troops despatched overseas, while the expenses of the untrained territorial troops sent to India to take the place of a small portion of the Indian troops, were to be borne by the Home Government. Thus, the Government of India defrayed the normal charges of a large number of its best troops, sent out of the country at a time when her safety required their presence at home, and thus no longer available for the defence of the country. Not satisfied with this sacrifice some critics blamed the Government for not bearing the actual expenses of the expeditionary forces, as well as the expenses of the territorial troops sent to India, and asserted that it did not comply with the spirit of the resolutions passed by the Viceroy's Legislative Council expressing its desire to share in the financial burdens of the war. The answer to this criticism is that Parliament allowed the Government of India to bear only the normal charges of the former, and required the Home Government to bear the excess in the actual charges of the former and the expenses of the latter, and that both the Indian and Home Governments had to abide by this decision of Parliament. Further, wherever any doubt regarding the various items of expenditure constituting the normal charges arose, its benefit was given to the Home

Government. The amount thus contributed towards the maintenance of the troops not available for the defence of the country, minus the charges of the British troops serving in India, which were borne by the Home Government, reached £ 11.5 million by the end of 1916-17, and £ 20 million by the end of 1918-19.

In addition to this contribution, the Government of India had to increase its military expenditure very considerably, because it became necessary to quell the disturbances of tribesmen on the North-West and North-East Frontiers, occasioned by the war, and to take special measures for the protection of the frontiers, and meeting the German menace. The pre-war annual military expenditure of the Government of India was £ 20 million. It rose to £ 23.5 million in 1915-16, 26.5 in 1916-17, 30.8 in 1917-18, 32.9 in 1918-19 excluding the additional burden undertaken in 1918-19, and $43\frac{1}{2}$ in 1919-20 excluding $14\frac{3}{4}$ spent on the Afghan War and 1.8 paid to the Home Government. Besides, the Government of India together with the Home Government had to undergo a large expenditure in Persia. Germany endeavoured to create disturbances in Persia, and the enemy troops, violating Persian neutrality, captured certain places of strategic importance. The Persian Government was unable either to resist the attacks or to preserve order, and the Home and Indian Governments had to come to its assistance. The part of the expenses borne by the latter came to £ 1.2 million up to March 1918.

Again, the vital importance of the financial aid afforded to the Home Government by the Government of India's war disbursements cannot be too much emphasised. It financed many war services, and the export of enormous amounts of foodstuffs and war material of various kinds. The disbursements amounted to £ 8.8, 23.6, 38.5, 66 and 76 million in 1914-15 and subsequent years. It was explained before and will be seen more fully later, how they gave rise to serious currency and exchange troubles and how restrictions on legitimate trade activities had to be imposed. Moreover a large part of the sums recovered from the Home Government was lent back to it by means of the purchase of British Treasury Bills. This virtually meant that during the war a large part of the sums disbursed by the Government of India for the Home Government was immediately as well as ultimately provided by the former. By the end of 1916-17 £ 46.5 million had been invested in the British war securities out of which £ 25 million represented wholly new investments. By the end of 1917-18 the latter were increased to £ 67 million.

From 1916-17 the Government of India refrained from borrowing in the London money market so as to leave it free for the loans of the Home Government. In 1914-15 the Secretary of State borrowed £ 7 million, but in 1915-16 he borrowed only £ 2 million after allowing for the discharge of debt, and this temporary debt was paid off in 1916-17 and the following year. Besides, throughout the war, a

continuous and increasing flow of generous contributions to numerous charitable war funds was kept up by Indian princes, chieftains, public bodies and individuals. Some idea, although an inadequate one, of these contributions may be obtained from the fact that the bare list of the larger donations published by the Government was long enough to fill more than 200 pages of a closely printed pamphlet.

India's contributions in man power, vitally affecting her financial contributions, surpassed the expectations of all. Her armies had not merely to protect her frontiers, but had also to assist the Empire in half a dozen theatres of war, in France, East Africa, Palestine, Mesopotamia, Salonica, Aden and the Persian Gulf. Some idea of the strain upon India in this respect may be obtained from the fact that by the end of the second year of the war, nearly 80,000 British officers and men, and 210,000 Indian officers and men, all fully trained and equipped, had been sent to the several war theatres. Throughout the war, the Indian Government continued to recruit, train, and despatch overseas larger and larger numbers. When the war broke out, there were in India 80,000 British officers and men and 230,000 Indian officers and men, combatants and non-combatants. During the war, the Government recruited on a voluntary basis 800,000 combatants and 400,000 non-combatants. Before the war the annual recruitment of combatants was 15,000. But the Government by strenuous efforts recruited 121,000

by May 1917, and over 300,000 by May 1918. India's efforts in the supply of man-power were further stimulated by the critical military situation in the early part of 1918, owing to the complete collapse of Russia and the German menace in Central Asia. The King-Emperor and the Prime Minister despatched messages to India asking her to redouble her efforts. Her response was full and prompt. A War Conference was held at Delhi in April 1918, and it was decided to contribute half a million combatant recruits during the year beginning with June 1918. Special central and local recruiting organisations were set up, in addition to the machinery created before, and by the time the armistice was declared, over 200,000 combatants had been recruited and there can be little doubt that the 300,000 recruits required during the remaining seven months would have been obtained if the recruiting operations had continued.

India's part in providing war material, which again deeply affected her financial contributions, was unequalled by any unit of the Empire, excepting of course England. India's effort in this direction has been so extensive, that it is not possible here even to summarise it adequately. India not merely equipped fully her expanding armies in several war theatres, but by supplying munitions of various kinds to the Allied armies, to the best of her abilities, substantially relieved the strain upon the manufacturing resources of England, the U. S. A. and France. Her resources in raw

materials are vast, but her domestic industries, destroyed by the competition of the western large-scale industries in the early part of the 19th century, have not been substantially replacd by modern industries. Yet India did her best in the matter, the Indian Munitions Board with its far-reaching organisation was set up in 1917, and rendered most valuable services. Jute bags and cloth, khaki cotton cloth, woolen blankets, boots and accoutrements, lubricants, steel rails, and vessels, especially river craft, were manufactured and despatched to several war theatres, to the fullest extent permitted by India's manufacturing resources. Moreover, she rendered valuable services in supplying raw materials and partly manufactured articles for the munitions factories and workshops of the other allied countries, such as wolfram, manganese ore, mica, saltpetre, timber, hides and skins, rubber, hemp, coir and petroleum. Her assistance in food-stuffs was hardly less important. Mr. Lloyd George in 1918 remarked that the people of Great Britain suffered some deprivation in the matter of foodstuffs, but not the pangs of real privation. This immunity was due in a considerable measure, to the large imports of food-stuffs from India. In all these matters, strenuous efforts were made to stimulate production, and so to increase the quantities available for export

These services and sacrifices of India, however, did not satisfy the above-mentioned critics, who set up a demand

that India should make a large direct gift to the Home Government. The Government of India resisted the suggestions that India was not contributing her fair share to the conduct of the war, but as the financial position had apparently somewhat improved by the end of 1916-17, it offered a special contribution of £ 100 million to the Home Government, with the consent of the Legislative Council. For this purpose, a war loan on a large scale was to be floated in India, its proceeds were to be handed over to the Home Government, and the balance of the contribution was to be liquidated by taking over a corresponding portion of the Home War debt.

The demand of the critics that the Government of India through the Home Government should move Parliament to be allowed to bear the total expenses of the Indian expeditionary forces, or that it should make a special contribution, could not be accepted at all till the end of 1916-17. In 1914-15 the public finances had been seriously dislocated by the war. The revenues declined considerably, and in addition a heavy drain upon the postal savings banks had to be faced. This compelled the Government to borrow £ 14 million temporarily. In the budget for 1915-16 a considerable deficit was anticipated, and as shown before, it was necessary to avoid fresh taxation. Such taxation was imposed in 1916-17, but the position on the north-west frontier was so uncertain and unfavourable that a larger military expenditure in connection with

it was probable, and therefore fresh direct liabilities for carrying on the war in other lands could not be undertaken. Moreover £ 9½ million of the temporary debt had still remained to be paid off.

India's sacrifices in the cause of victory did not end here. When the allied military situation became critical owing to the expansion of the German activities in the early part of 1918, the Government of India, in addition to redoubling its efforts in the supply of man power and munitions, decided to make a further gift of £ 45 million in the shape of meeting the normal expenses of 200,000 more men than it was then paying for, from 15th April 1918 and of 100,000 more men from 15th April 1919. The hostilities, however, terminated much earlier than had been anticipated, the Government of India had to undergo enormous expenditure on the Afghan war and the operations against the frontier tribes, and the actual gift came to 15½ million.*

The Government of India decided to raise as much as possible of its £ 100 million contribution by floating two large loans of unlimited amounts in India in 1917-18 and the following year. The adoption of this course resulted in three important advantages to India and the Empire.

* The reasons for reducing the original gift have been explained in chapter IV. See also the discussion in the Viceroy's Legislative Council, pp. 133 ff. of the Financial Statement and Budget, 1920-21

Firstly, it gave the Home Government fresh funds for the war instead of a mere reduction in the liabilities for the existing debt, and thus made India's gift more useful. Secondly, it gave the Government of India funds for meeting the huge war disbursements on behalf of the Home Government. Thirdly, India gained by her obtaining the means for the war gift in the form of internal borrowing, the interest on which remained in the country, and not in the form of merely taking over a part of the English debt, the payment of the interest on which would have left the country. In offering these loans, the Government of India followed closely the methods of the Home Government, and offered equally liberal terms. But their most important feature was that the previous narrow methods were abandoned in favour of fresh ones, designed to attract not only the persons already familiar with Government securities, but also those, who had not hitherto been in the habit of investing their money. The loan of 1917 was divided into four parts. Firstly, to the man of means desiring a semi-permanent investment was offered a 5 per cent war loan issued at 95, repayable in 1947, with the option to the Government of redemption from 1929 onwards, with certain rights of conversion of the existing 3, 3½ and 4 per cent Government securities, which were depreciating, and with a safeguard against depreciation in the shape of a sinking fund. This, however, was not suitable to banks, financial houses and many others, who in a spirit of patriotism, were desirous of doing their best to support

the loan, but who in justice could not be asked to lock up their funds for an indefinite period. To these were offered $5\frac{1}{2}$ per cent. short-term War Bonds 1920 and 1922, issued at par, free of income tax, and repayable in August 1920 and 1922 respectively. In order to bring the Government into closer contact with the smaller investor, a post office section of the above issues was established, in which special facilities were given to the small investor. Post Office Cash Certificates, free of income tax, and repayable at fixed rates at any time during a five years' period, were introduced as a permanent measure to bring the Government into relation with those, who had not thitherto acquired the investment habit. Cash Certificates of the eventual value, after five years, of Rs. 10, 20, 50 and 100 were to be sold at post offices for Rs. 7-12-0, 15-8-0, 38-12-0 and 77-8-0 respectively. The holder could cash them at any time within the five years, but in order to encourage the holding of the certificates for the full time, no interest was to be allowed on withdrawals within the first year, while with regard to those in the subsequent years, the interest was to be allowed on an ascending scale. The petty investor could have purchased the Government securities through the post offices in small instalments, but the advantage of the new scheme was that he could invest more directly and simply, and remain secure from any fluctuations in the value of the Government securities. In 1918, a long-term loan was not issued because the amount obtained from it in 1917 was much

less than that from the short-term bonds, and as it was thought that greater response would be obtained by concentrating upon the latter, the main section of the 1918 loan consisted of 3, 5, 7, and 10 year War Bonds, bearing $5\frac{1}{2}$ per cent interest, free of income tax, the last two being repayable at Rs. 103 and 105 respectively. The post office section consisted of the War Bonds, up to a certain maximum limit, and the five year cash certificates.

The success of these two war loans surpassed all expectations. In 1917, the 5 per cent loan yielded £ 8.3 million, the War bonds £ 21.2 million, and the cash certificates £ 6 million, in all a total of £ 35.5 million, the total number of investors, excluding the purchasers of the cash certificates, being 155,103. It was feared that the second war loan in 1918 would be less successful, as it was believed that the investing public had in the previous year invested almost up to the full limit of their resources But the second war loan did even better than the first. The main section of the loan yielded £ 34.3 million, and the post office section £ 3.7 million, in all a total of £ 38 million, the number of subscribers being no less than 227,706. The importance of these figures will be better understood, when it is pointed out, that, before the war, the largest rupee loan amounted only to £ 3 million, taken up by 1,172 subscribers.

The remarkable success of the war loans was due to three causes. Firstly, certain merchants and manufacturers

were making large profits as a result of the war conditions, and as it was difficult to find an outlet for the accumulated capital, again owing to the war conditions, it was invested in the war loans. Secondly, the appeal to the national as well as the imperial patriotism of the people by means of a widespread campaign met with a remarkable response. But, the most important cause was a radical alteration in the loan policy of the Government. Till then the Government loans had been subscribed o, only by banks, financial houses and a few large investors, the ordinary investor being scared away by all sorts of formalities and complications, and no direct efforts being made to promote the investing habit. This policy of inaction was abandoned in the case of these two loans. In the first place, provincial and local loan committees were organised, the co-operation of a host of non-official workers was enlisted, and a vigorous and widespread campaign was conducted to get people to subscribe by all possible methods. Secondly, all sorts of facilities were given to the ordinary investor. He was allowed to purchase the scrip not only at the head-office and branches of the Presidency banks and the offices of the Controller of Currency, any Accountant-General or Comptroller, but also at any Government treasury or sub-treasury or at any post-office conducting savings bank business; he was allowed to pay in instalments; some of the formalities thitherto obstructing the transfer of Government securities were abolished: the post-office investment rules were

simplified, and the limit up to which such investments secured an exemption from the income tax was raised to Rs. 15,000. Thirdly, for the convenience of investors in large business centres, short-term bonds, registered as well as bearer, were introduced. Fourthly, to the holders of the Government securities existing at the time, conversion facilities were offered. Fifthly, in order to create and promote the investing habit, cash certificates were introduced, which were free from fluctuations in price, which could be cashed at any time, and which after the first year yielded compound interest on an ascending scale. Lastly, the amount subscribable to the main sections of the loans was unlimited, and to prevent the depreciation of the securities, a depreciation fund was created by annually setting aside a sum equal to $1\frac{1}{2}$ per cent of the loans and was to be utilised for buying in the securities as soon as they fell below the issue price. These are some illustrations of the new loan policy, which radically differed from the old one.

These two war loans taught the most valuable lesson that poor as the people of India were on the whole, their small savings could be attracted by the Government and banks for profitable uses, if proper facilities for investment were given, if the formalities of the transactions were reduced and if the whole procedure was simplified. The masses require to be educated in the habit of banking, and their ignorance stands in the way of progess in this as in

many other directions. But the success of the war loans showed that their response was remarkable if the problem was tackled in the right spirit and if their confidence was secured by well-conceived schemes. The large number of the subscribers to the loans was the most promising feature for the future for three reasons. Firstly, India's economic advance in the near future will primarily depend upon the full utilisation of her vast natural resources which hitherto have largely been either neglected or exploited by others, and this will require a very large outlay of capital both by private enterprise and the Government. It has already been pointed out that at least for some years, India will find it difficult to borrow large sums in the London money market, and that in this respect she will have to depend largely upon her domestic resources. Secondly, although too much has been made of Indias' wasteful hoarding habit, it must be admitted that there is a large element of truth in the assertion, and it is essential to encourage throughout the country the investment habit, which will avoid the waste involved in her hoarding of the precious metals. Lastly, the growth of the investment habit will solve some of the pressing financial difficulties of the Government by diminishing in the near future India's demand for additions to her metallic currency. After the failure of the efforts to popularise state loans towards 1890—efforts marked by the issue of Stock notes and Provincial debentures—the Government pursued an inactive policy in its loan operations, which were only meant to attract a few banks

and financial houses, and which almost entirely neglected the requirements of the ordinary or potential investors. The stress of the war circumstances led the Government to adopt a more active policy, and the results seemed to show that its earlier adoption would probably have been productive of much benefit. It is essential, however, that the progress in this direction should be accompanied by the proper development of banking, without which the full advantage of the advance in its new loan policy cannot be secured to the Government.

The war contribution of £ 100 million and the consequent war loans entailed a large addition to India's national debt.

INDIA'S NATIONAL DEBT IN £ Million.

	Ordinary Debt, including floating debt.	Productive public works debt Railways	Irrigation	Total.	Total debt.
31st March 1913 ..	25.0	211.8	37.6	249.4	274.4
,, 1914 ..	12.8	222.0	39.4	261.4	274.2
,, 1915 ..	9.2*	233.2	41.1	274.3	283.5
,, 1916 ..	9.0†	234.4	42.4	276.8	285.8
,, 1917 ..	7.0‡	235.7	43.3	279.0	286.0
..	53.4§	239.1	44.0	283.1	336.5
30th Sep. 1918 ..	..	..	..	..	370

Table 25.

* Excludes £7.3 million of temporary loans from the Gold Standard Reserve and Gwalior State.
† ,, £4.3 ,, ,,
‡ ,, £0.3 ,, from the Gwalior State.
§ ,, £2.9 ,, Bank of Bombay and
£64.0 of the liability for British Government war loan 1929-47 taken over as part of the financial contribution to the war.

The position of India's national debt at the end of the war as compared with those of the national debts of the advanced countries appears to be satisfactory.* At the end of September 1918 India's national debt amounted to £ 370 million or about £ $1\frac{1}{2}$ per head of the population as compared with a total public revenue, central and provincial, of about £ 110 million. Moreover, the revenue from that part of the debt, which was expended upon productive works, exceeded the interest charges for the total debt by 33 per cent. However, a closer examination reveals some rather unsatisfactory features in the national debt. One such feature was that, while by far the larger portion of the national debts of the Western countries is held by the children of the soil, in the case of India, a large part of the debt was held outside the country, and the proportion went on increasing before the war, as the following figures show:

INDIA'S PUBLIC DEBT HELD IN INDIA AND ENGLAND IN £ MILLION.

Year.	In India	In England	Total.
1839-40	32.8	1.7	34.5
1857-8	60.7	8.8	69.5
1860-61	71.9	30.0	101.9
1879-7	83.5	55.4	138.9
1890-1	78.4	104.4	182.8
1901-2	91.9	134.3	226.2
31st March			
1902	77.5	130.3	207.8
1907	87.0	147.5	234.5
1911	92.1	178.0	270.1
1912	93.3	178.5	271.8

Table 26

* See Appendix 4.

The growth of the sterling portion of the debt was one of the causes of the exchange difficulties. The Fowler Currency Committee of 1898 recommended that the Government of India should husband the resources at its command, exercise economy and restrict the growth of its sterling obligations. However, the above table shows that between 1902 and 1912 the sterling portion of the debt increased by nearly £ 50 million. This increase was largely due to the inactive loan policy in India explained above. If the numerous measures taken in connection with the war loans had been carried out a little earlier, the Government in all probability would have raised much larger sums in India, and consequently it would have had to borrow less in England. During the war, the national debt increased considerably, chiefly on account of the contribution of £ 100 million, but as ⅔ of the contribution was raised in India, the proportion of the rupee debt to the total debt has appreciably increased. The disadvantage of a considerable increase in the debt is thus partially set off by the fact that the bulk of the increase is held in the country. The proportion of the rupee debt will probably increase in the near future, because, as was already pointed out, it will be difficult for some time to borrow large sums in London, and a greater reliance will have to be placed upon loans floated in India.

There were also some defects in the methods of floating the loans, especially in England, before the war. In some

cases, the market conditions were not fully taken into account, the most favourable opportunities for borrowing were allowed to pass by and loans were floated when market conditions had become less favourable. Secondly, there was sometimes an absence of a comprehensive plan of borrowing, and sums were borrowed in a piece-meal fashion The fact that it was known that India would continue to borrow annually probably tended to keep down the quotations for the Indian Government securities in the London market. Thirdly, unlike colonial loans, most of the Indian loans had no definite date for redemption, with the result that the Indian securities declined more than the colonial. Lastly, during the few years before the war, to overcome the consequences of the above defects, the practice of underwriting the loans, raising the rate of interest and lowering the issue price was sometimes followed. This tended to lower the credit of the Indian Government. Most of these defects were pointed out by Mr. Cole, the Governor of the Bank of England, in his evidence before the Chamberlain Commission 1913. During the war there was not much borrowing in London. Soon after the outbreak of the war, £ 7 million were raised by means of India Bills, which, however, were paid off as soon as the financial situation showed some improvement. There was some borrowing in 1915-1916, but from 1916-1917 all indenting on the home market was completely stopped. Therefore, sufficient data are not available to decide whether the above-mentioned defects have been removed from

the loan policy of the Indian Government. However, the large loans in India were floated very systematically. They were floated at most opportune times; the rate of interest was not higher than the prevailing conditions warranted: the bonds had a short duration; and also the loan 1929-47 had a definite duration; and a depreciation fund was created to prevent the issues from declining in price. It is true that the loans increased the depreciation of the older Government rupee securities, which resulted from war conditions and the rise in prices, and that the considerable depreciation in the value of the securities, imposed an appreciable hardship upon those of their holders who belonged to the middle classes, and possessed very limited means. This result, however, was unavoidable under the circumstances. It may therefore be concluded, that during the war, apart from the question of the justification of increasing the national debt, the methods by which it was increased showed a considerable improvement upon the pre-war methods.

CHAPTER VIII.

Currency and Exchange.

The currency and exchange problems arising out of the war were closely connected with the Ways and Means position examined in an earlier chapter under a two-fold division of the war period, and they should be examined similarly, the first division extending over 1914-15 and 1915-16 and the second over the subsequent years. For here also, the factors at work and the difficulties resulting therefrom were different during the two parts of the war period, and different measures had to be taken to meet the difficulties. The currency and exchange problems during the first part were the outcome of the operation of the two forces previously explained, *viz.* the loss of confidence in the financial soundness and stability of the Government of India on the part of the ignorant masses and even of some literate people, chiefly Marwari money lenders, who were influenced by a vague and unwarranted sense of insecurity and the dislocation and depression in India's foreign, especially export trade. The first factor gave rise to the serious run upon the postal savings banks and to the wide-spread demand for the encashment of currency notes, which have been fully examined in a previous chapter. The general situation was aggravated, and the internal credit was seriously prejudiced by the action of many members of the Marwari class, which played an important part in financing the internal trade of the country. Instead

of conducting their business as usual, they made haste to turn into cash as much of their capital as possible and to return to their homes in Rajputana, thus considerably obstructing the working of the credit machinery of which they formed an important part. They scrambled for gold, and to restrict its dissipation the Government decided not to issue gold to any one person or firm to a less amount than £ 10,000 hoping thereby to distinguish between the demand for gold for remittance purposes and for hoarding or internal requirements. The Marwaris, however, were too astute for the Government, and defeated its purpose by clubbing together their requirements so as to make up the minimum demand for £ 10,000. The Government in this way lost £ 1.800,000 worth of gold within four days, and on 5th August stopped the issue of gold altogether to private persons.

The operation of the second factor, *viz* the dislocation of the export trade gave rise to the external aspect of the currency problem by weakening the exchange. The government had supported exchange during the crisis of 1907-8 and the Chamberlain Commission on Indian Finance and Currency only a few months before the war had recommended the maintenance of this policy. The Government therefore decided to adhere to the policy pursued in 1907-8 and improved upon it in some respects. Firstly, it formally undertook to support exchange by all the means in its power, at the outset of the crisis, without

any loss of time, when the time-factor was vital. Secondly, to carry out the object, it offered for sale sterling bills on London, reverse Council drafts as they were called, up to a maximum limit of £ 1 million a week until further notice. The Government thus undertook beforehand to maintain the sales to a large amount, whereas in the crisis of 1907-8 the amount of the sale was determined afresh just before each weekly sale. Thirdly, the bills were paid in London 16 days after the departure of the weekly mail from Bombay, thus avoiding the uncertainty resulting from a delay in the arrival of the bills by mail steamer. Fourthly, telegraphic transfers were sold so as to provide immediate remittance to London for those requiring it. The results of these arrangements were very satisfactory. Confidence was restored in the commercial community, which was assured of sufficient and continuous remittance facilities provided by the vast resources of the Government. The absence of any fear that the Government might suddenly reduce the sale of the reverse council bills and telegraphic transfers eliminated speculative competition for them, which had been a feature of the sale in 1907-8. The applications exceeded the £ 1 million limit of the sale only in the first week. From the second week the demand gradually lessened and when the immediate requirements for remittance were met, the demand fluctuated within moderate limits for some time, then sank to a small amount, and finally in January 1915 disappeared altogether. In all, the bills and transfers

were sold to the extent of £ 8.7 million. The amounts received from the sale were credited to the Gold Standard Reserve in India, while the bills and transfers were paid in London out of the Reserve there. Moreover, in accordance with the recommendation of the Chamberlain Commission, £ 4 million of silver held in the Reserve in India was exchanged for an equivalent amount of gold held in the Paper Currency Reserve in India. The Gold Standard Reserve in India was thus temporarily strengthened to a considerable extent. Exchange again fell in June 1915, and the Government supported it as before by the sale of reverse Council bill and telegraphic transfers. The depression, however, was of a comparatively short duration, and continued only till September. It was connected in part with the system adopted by the Government of India of financing the purchase of wheat on behalf of the Home Government by direct payments in India to the firms employed as purchasing agents, as well as with the demand for remittance in connection with subscriptions to the Home war loan. When these transactions were completed and renewed trade activity, which normally begins in winter, set in, the exchange situation was reversed, and finally a strong demand arose for the Secretary of State's Council bills for the purposes of trade remittances. A part of these bills were cashed out of the Gold Standard Reserve in India, while the sums received in payment thereof were credited to the Reserve in England, which thus regained its strength.

It must thus be admitted that during the first part of the war period India's gold exchange standard displayed a considerable strength. There was no such sudden tumble in exchange, as had been forecasted when the war was threatened, and the stability of the rupee was maintained. No necessity was felt to resort either to the device of a moratorium as in England, or to the inconvertibility of the paper currency as in France and Germany. Moreover, all obligations were discharged without any special assistance from foreign sources. This temporary stability of the gold exchange standard gratified its supporters, who asserted that the war had vindicated the truth of their contentions.* However, in the first place it should be noted that the stability of the system was achieved by means of an artificial management on the part of the Government. Secondly, it may be pointed out that the rupee was virtually inconvertible into free gold. Thirdly, the stability proved short-lived, and during the second part of the war period, exchange left its old moorings and proved a source of considerable embarrassment, anxiety and loss.

The second part of the period was characterised by highly important events. It witnessed a partial breakdown of the gold exchange standard system, a progressive and abnormal rise in exchange, an unprecedented demand for silver coins to finance the war work in India and in countries where Indian troops were fighting, a considerable inflation of the paper currency, and a dislocation in the

* See for instance Spalding, Eastern Exchanges, First Edition.

mechanism of the Government finance and of trade finance also, owing to the intimate dependence of Indian trade on the financial machinery of the Government. Thus, the difficulties of the Government and trade had two aspects, the external one, connected with the rise in exchange, and the internal one, relating to the expansion of the currency. The causes of these difficulties were alluded to in examining the Ways and Means position, and they may now be considered from the point of view of the currency and exchange position. It is desirable to consider first the external aspect connected with the rise in exchange. Before the war, a substantial portion of India's favourable balance of trade *i. e.* the excess of the exports of merchandise over its imports, took the form of the import of the precious metals by private agency and the remainder of the excess that of the remittances, which the Secretary of State placed at the disposal of the trade through his Council bills, which were sold by him to place himself in funds to meet his expenditure in England. During the second part of the war period, however, the exports, on the one hand, though restricted by freight and exchange difficulties, increased as compared with the level to which they had fallen during the first year of the war, because raw materials and partially and fully manufactured goods were urgenly needed by the allied countries for the conduct of the war, without much consideration of their prices, which rose higher and higher, and the imports into India declined, on the other hand, as the manufacturing countries of the West could export

less goods to India on account of the concentration of their energies and resources upon the war. Consequently, India's favourable balance of trade increased in value. The average for 1916-17 and the two subsequent years when the currency difficulties were most serious, was £ 60 million as against the average of £ 53 million for th last three years of the pre-war period. Even in normal times, it would not have been easy foı India's customers abroad to meet this increased balance. But the difficulties were enormously increased during the second part of the war period, as the import of gold and silver bullion into India, which was the form taken before the war by the larger part of the balance, was reduced considerably. The export of gold to India was not allowed on account of the supposed necessity of concentrating the gold reserves of the Empire in its interests, and silver became increasingly difficult to obtain owing to the keen demand for it,and in July 1917 all private imports of silver into India were stopped. The consequence was that the favourable trade balance took the shape of a greater demand for the Secretary of State's Council drafts. The Secretary of State, however, was unable to satisfy the demands of trade in this respect for two reasons. In the first place, the sale of the Council bills which were cashed in India, imposed a heavy strain upon the Government of India's balances, which were being depleted by the enormous disbursements exceeding £ 250 million, which it had to make on behalf of the Home and Colonial Governments and which it recovered in London.

Thus, the strain upon the rupee balances in India caused by the war disbursements diminished the Secretary of State's power of offering Council bills at the very time when the demand for them increased. The Secretary of State, therefore, had to limit the sale of Council drafts, and this produced an adverse effect upon the export trade. Secondly, the Secretary of State's financial requirements were covered several times over by the recovery of the disbursements in India, and consequently there was no need for him to sell Council bills, so far as his requirements were concerned. Now the rupee exchange means the sterling price in London of the command over rupees in India. It is the amount of sterling in London to be paid there for one rupee in India to be obtained at once by means of telegraphic transfers or after a certain time by means of Council bills or the ordinary bills of exchange. As the increase in the net liabilities to India i.e. in her balance of trade could only to a small extent take the form of the exports of the precious metals to her, there was a greater demand in London for the right to rupees in India. Its supply on the other hand, was reduced on account of the strict limit to the sale of Council drafts. Consequently the price in London of the command over rupees in India increased; in other words, the rupee-sterling exchange rose. This was then the first cause of the rise in exchange.

The significance of the difference between the pre-war and war times as regards the favourable trade balance

taking the shape of private imports of the precious metals, will be made clear by the following figures:—

India's Balance of Trade in £ million.

	1909-10 to 1913-14 pre-war average	1914-15 to 1918-19 war average	1914-15	1915-16	1916-17	1917-18	1918-19	1919-20
Net Exports of merchandise (excess of exports over imports) ..	52.18	50.87	29.1	43.6	63.68	61.42	56.55	79.4
Net imports of treasure and funds ..	52.46	27.29	11.27	26.44	33.28	49.83	15.65	15.5
(a) Council drafts	28.41	20.1	—1.05*	19.46	31.92	34.55	15.6	12.1
(b) Treasure	24.05	7.2	12.31	6.98	1.36	15.28	0.05	3.4
Balance of trade in favour of India		23.58	17.84	17.15	30.39	11.59	40.9	63.9
Balance of trade against India ..	0.28	..	..	..	..	..	..	

* Indicates the excess of the sale of reverse Council drafts over that of the council drafts.

Table 27.

During the five pre-war years the total excess of the exports over the imports of merchandise was about £ 262 million and took the shape of a net import of funds by means of Council drafts amounting to £ 142 million, and of the import of treasure to the extent of £ 120 million on private account, 80 per cent of which was in gold. During the five war years the favourable balance of trade came to £ 254 million, and took the form of a net import of funds amounting to £ 100 million, and of a very low import of treasure of £ 36 million only. The import of treasure in 1916-17 was small, practically ceased during 1918-19, and did not revive substantially even in 1919-20. The comparatively high import in 1917-18, chiefly from

Japan and the U. S. A. was due to the great difficulties of securing rupee exchange on account of the limitation of the sale of Council bills. The average net imports of gold during the five pre-war years were £ 19 million a year, of which £ 12 million were sovereigns. In the five war years the average came to only £5 and 2 million respectively. Thus, the annual average import of gold during the war was less than its import in any of the twenty-five pre-war years excepting famine years. Hence, during the war India had to accumulate deferred payments abroad, as her foreign customers were not able to export treasure to her in part payment for her exports, as they used to do before the war. India's demands for the precious metals during the war were not unreasonable as compared with the pre-war standards, because, while her absorption of gold, silver and rupees during 1909-14 was Rs. 224 crores, it came to Rs. 165 crores only during 1914-19. During the five pre-war years 80 per cent of the import of treasure consisted of gold, which, to a far larger extent than silver, was employed in meeting the trade balance. During the war, however, India was practically starved of gold, although certain countries were allowed to import large quantities of gold. It was shown in table 23 that, while certain countries with a total population of 170 million imported gold worth £460 million during the war, India, with a population nearly twice as large, had to be content with the import of gold worth £ 26 million only.

The second cause of the rise in exchange may now be considered. The war disbursements in India, recovered in London, continuously transferred enormous funds belonging to the Government of India from India to England, and the question was how to bring them back, so as to replenish the balances. which were being depleted on account of the strain imposed upon them by the war disbursements and the encashment of Council drafts. The import of gold was considered prejudicial to the interests of the Empire. The earmarking of gold in London, and the issue of currency notes against it in India was also thought to be opposed to the interests of the Empire. The only course left open to the Government was to import silver on its own account, to coin it into rupees so as to prevent its balances from remaining below the minimum necessary for safety, and to ward off the threatened inconvertibility of the note issue. Large purchases of silver thus became necessary at a time when the world's production of silver, especially in Mexico, had fallen off, as shown in the report on the World's Production of Silver by Professors Carpenter and Cullis, the stocks were very low, and the competition for it was very keen. The Secretary of State removed all private competition, so far as India was concerned, by prohibiting the import of silver into India on private account. But he could not remove the competition of some other countries, where also the economic situation required an increase in the silver currency. The result was that the gold price of silver began to advance, subject

to some fluctuations, rather slowly and steadily, at first, but somewhat rapidly afterwards. The sterling price of silver rose much more rapidly after the middle of 1919,* on account of the depreciation of the dollar-sterling exchange, resulting from the removal of the Government support. This continuous advance entailed a progressive raising of the exchange value of the rupee, on the basis of the rates at which the Secretary of State sold his Council drafts, until at last it was raised from 1s 4¼d. in August 1917 to 2s. 4d., in December 1919 per rupee, an advance of nearly 1s. per rupee in a little more than two years. The reason for this rise was that as the sterling price of silver rose higher and higher, the bullion value of the rupee exceeded its legal value after certain intervals, and the Government acted upon the principle that it could not supply large quantities of new rupees at a substantial loss, which would have resulted from the maintenance of the sterling value of the rupee at its old level. Moreover, if the legal value of the rupee had been maintained at its old level in spite of the rise in the price of silver, it would have become profitable to melt and export rupees.* It is true that the Government made it a legal offence to melt or export rupees, but while such prohibitions might prove useful to some extent as temporary devices, they could not have acted as permanent checks upon the demand for rupee currency for melting and exporting purposes

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* See Appendix 5.

of the producers of other countries, when the demand for India's staple products was large and unsatisfied, and when, on account of the shortage of tonnage, exporters were able to export all the goods for which shipping could be secured. Secondly, although exporters might be receiving somewhat lower rupee prices than they would otherwise have done, owing to the rise in exchange, the actual rupee prices obtained by them were materially higher than the pre-war prices. And thirdly, India was not the only country affected by exchange difficulties. Most countries of the world experienced similar difficulties, and in some of them, especially in France and Italy, exchanges diverged more from the normal than in India, and in addition were subjected to indefinite fluctuations. It must be admitted that there was much truth in the first argument during the continuance of the war. But with the cessation of the hostilities and the gradual re-establishment of normal conditions, the competition of other producing countries with India has revived, and at the same time India's exchange difficulties, far from diminishing have actually increased. India has keen competitors in the export of all her products with the exception of jute, and since the revival of competition, the rise and fluctuations in exchange have been materially handicapping her in her competition with the other producing countries. With regard to the second argument it should be noted that the mere fact that the exporters obtained higher prices than those ruling before the war did not necessarily show that

the increase in the demand for their products benefitted them. For, owing to the general rise in prices in India, their expenses of production and the cost of living substantially increased, and unless it can be proved that the prices obtained by the exporters for their products were substantially higher than the increase in their expenses of production and living, it does not follow that they benefitted materially from the greater demand for their products. Lastly, it is not possible to compare India's exchange troubles with those of other countries such as France and Italy, because the conditions were so different and there was no common basis for comparison. The other countries had to import commodities for the conduct of the war without any consideration of their prices and quantities, or of their effect upon the balance of trade and the foreign exchanges, because their very national existence was at stake. With them the problem was one of an adverse balance of trade and a depreciation in the foreign exchanges.* The position in India was the reverse, and high exchange was an obstacle in the way of India's efforts to assist the prosecution of the war, by exporting as much war material as possible.

The actual movements of exchane may now be briefly explained. The weakness in exchange from August 1914 to January 1915 and again from June to September 1915,

* Cf. Currencies after the War, issued by the Secretariat of the League of Nations, 1920.

and the sale of reverse Council drafts have already been explained. The demand for Council drafts recommenced from September 1915 and continued moderate till the end of January 1916. The demand became strong during February and March, and a large amount of Council bills was sold. Thereafter the demand became more moderate till the end of October 1916, when the period of trade activity began, the demand for Council drafts assumed an extraordinary strength and the weekly sale of drafts averaged over £ 2 milion. The rupee balances in India, however, sank so low that the continuance of the sale of the drafts on such a large scale would have involved the danger of falling short of rupees for the redemption of currency notes, and of having to declare them inconvertible. Therefore, from the beginning of 1917 the Secretary of State restricted his weekly sale of the drafts, the weekly amount, which varied between Rs. 120 and 30 lakhs, being fixed from time to time on a consideration of the rupee balances in India. This limitation of the sale of the Council drafts at a time when the demand for them was very strong on account of the deficiency of the alternative methods of remittances to India, resulted in a divergence between the market rate of exchange and the rate at which the drafts were sold. It also became clear that the available remittances might be inadequate for financing the entire export trade, and that therefore the exports urgently required for war purposes might be adversely affected. Hence, from January 1917 the sale of the Council drafts

was confined to certain exchange banks and firms, at a fixed rate, on the condition that they must transact business with third parties at prescribed rates and apply their funds chiefly to financing exports for war purposes. Moreover, in order to induce the exchange banks to buy export bills in India in excess of their purchases of exchange in London, the Secretary of State promised to sell them within a year after the cessation of hostilities, Council drafts to the amount of their overbuying in India, at the rate at which it had been done, and thus effectively insured them against the risk of a loss in the re-transfer of the funds to India later, owing to a rise in exchange. This Government control differed radically from the pre-war system of a free and unlimited sale of the drafts, but it achieved the objects aimed at, namely the provision of adequate finance for war exports, and the maintenance of the market rate of exchange near the rate of the drafts. After the cessation of hostilities, this control gradually disappeared, the overbuying guarantee was terminated, and from September 1919 the pre-war system was resumed, so far as the sale of the drafts by open competitive tenders, subject to a minimum rate, was concerned. The amount of the drafts offered weekly, however, continued to be fixed on a consideration of the resources in India and the intensity of the trade demand.

From the beginning of 1916, however, the price of silver began to break away from its pre-war level of about 26d.

per standard ounce, and as it rose, exchange also broke away from its normal level of 1s. 4d. per rupee, and climbed after it. In the early part of 1917 the demand for remittances was so heavy that the rate of 1s. 5d. per rupee was quoted. The Exchange banks endeavoured to fix the rate by an agreement, but failed. Thereupon the Secretary of State, as explained above, succeeded in making arrangements with them by which they agreed to base their transactions on the rate of 1s. 4¼d. This rate remained in force till the end of August 1917, when it had to be raised to 1s. 5d. on account of a further rise in the price of silver. In September 1917 the U. S. A. Government established control over the trade in silver by prohibiting its export except under license. This control somewhat checked the tendency of the price of silver to rise. In April 1918 the rate was further raised to 1s. 6d. but the position was stabilised for some time by the purchase of American silver.. The reserve of the American silver had been held at the rate of 1 dollar per ounce and that rate determined the price at which the U. S. A. Government sold the silver to the Government of India, which agreed not to purchase any silver at a higher price so long as the Pittman Act remained in force . About October 1918 a new problem arose. The monsoon failed over large parts of India, the exports fell off , especially on account of the stoppage of wheat exports, and the demand for remittance quickened and considerably exceeded the supply of export bills, which had fallen off. The sale of the Council drafts

was stopped to remedy the weakness in exchange, but this did not suffice, and the sale of reverse Council drafts became necessary. The problem concerned the rate at which the reverse drafts should be sold. In pre-war times, when the intrinsic value of the rupee was less than 1s. 4d the problem was simple, and the reverse drafts could be sold promptly, on the appearance of weakness in exchange, at the rate of 1s. $3\frac{29}{32}$d. But, in the conditions brought about by the war the problem was difficult. The Government, however, ultimately decided to maintain the stability of exchange at the rate then existing and began to sell immediate and deferred reverse telegraphic transfers at the rate of 1s. $5\frac{31}{32}$d. and 1s. $6\frac{1}{32}$d. respectively. This decision of selling reverse drafts about the rate of exchange prevailing at the time of the sale was adhered to with the subsequent increases in the rate. In May 1919, the U. S. A. and Home Governments withdrew the control over the silver market, and after that date, mainly owing to the exceptional demands from China, the price of silver advanced rapidly, and in the middle of December stood at 78d. per standard ounce. The other cause, mentioned above, of this enormous rise in the price of silver in the London market viz. the depreciation of the dollar-sterling exchange became also operative. During the war the British and American Governments supported the sterling exchange on the U. S.A. at $ 4. 76 to the pound sterling. This support was withdrawn in March 1919 and after that date the dollar-sterling exchange declined heavily against

London. As the U. S. A. is the main source of the world's supply of silver, most of the payments for the metal must ultimately be made in that country. Hence the sterling price of silver takes account of the condition of the dollar-sterling exchange, and any rise or fall in that exchange affects the price of silver in the London market. Thus, a fall in the London-New York exchange has the effect of raising the sterling price of silver in London, although its gold price as measured in dollars may remain unchanged. Along with this rapid rise in the sterling price of silver, the rate of exchange also climbed up with the same rapidity. In may 1919 the rate was raised to 1s. 8d., in August to 1s. 10d., in September to 2s., in November to 2s. 2d. and in December 1919 to 2s. 4d., when the report of the Smith Currency Committee was issued . The rapidity of the advance in the rate was staggering, as within 8 months the rate rose from 1s. 6d. to 2s. 4d. and dislocated the export trade.

Attention may now be turned to the internal aspect of the currency and exchange difficulties, which was intimately connected with the external aspect, which has been so far explained. The huge war disbursements on behalf of the Home Government grew larger with the progress of the war,and necessitated the issue of large amounts of currency. The recovery of the disbursements covered the requirements of the Secretary of State several times over, and rendered it unnecessary for him to sell Council drafts, so

far as his requirements were concerned. But, as seen above, he had to sell them in large amounts for trade purposes and the encashment of the drafts in India also necessitated the issue of currency in large amounts. It was seen in the chapter on Ways and Means how enormous the total disbursements of the Government of India became. They were made to some extent out of the revenues and the proceeds of the war loans, but to a far larger extent by putting into circulation some gold and large volumes of silver and paper currency, and by the creation of credit. This was the main cause of the continuous upward movement of prices in India to be examined later. The disbursements could be made out of the revenues and the proceeds of the war loans to a limited extent only, and therefore a large part of the disbursements could be made only in three ways, by the issue of rupees, gold and notes. The Government did issue gold coin and bullion at those times when the strain upon the rupee balances became specially severe. But the issue gave little relief, because the Government had no large stocks of gold, the import of gold was considered prejudicial to the interests of the Empire, and whatever issue was resorted to, was made in a piecemeal and half-hearted fashion, with the result that the premium upon gold immediately drove gold coin out of circulation. Under the currency policy pursued by the Government, the issue of gold coin was an emergency ration rather than a currency medium, and could not be otherwise. The issue of notes was resorted to as far as possible, even much beyond the

limits of prudence. But, there were obviously definite limits to the issue of notes, especially in India. The issue was chiefly limited in two ways. Firstly, it depended largely upon the extent to which the supplier of goods or services was prepared to accept them. The supplier in the country districts was generally not very willing to acccept notes, and became especially unwilling to do so when they went to a discount. Secondly, the Government had to endeavour to keep an adequate metallic reserve to enable it to cash them on demand. Any effort on a large scale to force notes upon the public would have shaken its confidence in Government credit, and would have resulted in a serious depreciation of the notes and inflation of prices. The Government as a matter of fact, did overstep the limits in a substantial degree. As will be seen presently, the metallic backing of the notes became inadequate, the facilities for their redemption had to be curtailed, they went to a discount, and in some cases their issue practically amounted to a compulsion to accept them. However, the passing of these limits beyond a certain degree would have produced a catastrophe, and therefore the Government could not go beyond a certain point in the issue of notes, without incurring grave dangers.

Thus, in making the huge disbursements, the issue of gold gave little relief, and the issue of notes could not be resorted to beyond a certain point, without inviting a financial breakdown. It therefore becomes evident that the

only course for the Government was to issue rupees in immense quantities. The pressure of the enormous disbursements fell very largely upon the rupee balances, which were being constantly depleted. If these balances had fallen below a certain minimum, the inconvertibility of the note issue would have been inevitable, and the whole financial structure of the country would have felt its harmful effects. It was essential for the Government, therefore, to go on purchasing large quantities of silver, coining them into rupees, and replenishing the constantly diminishing balances, so as to keep them up at the minimum consistent with safety, and to ward off the threatened inconvertibility of the note issue. The Secretary of State with the resources transferred from India to England, by means of the recoveries of the war disbursements, endeavoured to purchase as much silver as possible. But, as explained above, the circumstances were very unfavourable. However, in spite of the difficulties, the Secretary of State succeeded in purchasing and remitting to India large quantities of silver from 1916-17, as shown by the following figures :—

World's Production of Silver, its net Imports into India, and price in London.

	Pre-war average 1909-10 to 1913-14	1914-15	1915-16	1916-17	1917-18	1918-19	1919-20
World's production .. (million ounces)	222	161	180	161	164	180	17
Net Imports into India (million ounces)	62	56	83	92	75	237*	113*
Price of silver .. (pence per ounce in London)	26	$25\frac{5}{16}$	$23\frac{11}{16}$	$31\frac{5}{16}$	$40\frac{3}{8}$	$47\frac{9}{16}$	$65\frac{11}{16}$

* Includes imports from the U. S. A. under the Pittman Act.

Table 28.

These large imports, however, did not suffice to meet the needs of the Government of India which had to pass through a silver crisis in 1918, when its rupee balances sank very low, and had it not been for the timely assistance of the U. S. A. Government, which sold large amounts of silver out of its reserve to the Government of India, the inconvertibility of the note issue could not have been avoided, and a serious financial crisis would, in all probability, have followed. Therefore the position of the Government balances and the strain imposed upon them by the enormous disbursements may now be examined.

At the outbreak of the war, the Government held a very large stock of rupees amounting to about Rs. 40 crores, and after the declaration of the war the issue of gold was stopped, and the reserve of £ 10 million of sovereigns was conserved for future necessities. During the early part of the war, it was unnecessary to increase this large stock of rupees at the cost of the Government gold reserve in London, and it would have been unsafe to do so, because the real danger lay in the possibilities of a weakness in exchange, and the future needs for disbursements could not have been foreseen and provided for. About January 1916 the sale of Council drafts became large, but the rupee balances were still exceptionally strong, and no strain was felt by the balances, until the slack season reduced the sale of Council drafts. The Government, however, perceived the shadows of the coming events

and in February 1916 pointed to the Secretary of State the desirability of his resuming the purchases of silver. The purchases then began, and continued on a large scale in spite of the rise in the price of silver. During the busy season of 1916-17 the sale of Council drafts became very large and the strain upon the balances became very considerable, as will be seen from the fact that during 1916-17 the net issues of rupees to the public amounted to no less than Rs. 35 crores. However, large quantities of silve were purchased and coined, the balances were replenished to some extent, and a silver crisis was avoided, thoughr not without some difficulty.

The silver position, however, became very grave during the busy season of 1917-18. The net issues of metallic currency to the public from the commencement of the financial year 1916-17 to the end of February 1918 including 8 crores (over £ 5 million) of sovereigns, reached the tremendous figure of Rs. 67 crores. The Secretary of State continued to purchase as much silver as possible, but the circumstances already explained made it impossible for him to obtain more than a limited quantity in the open market. The rupee balances sank lower and lower, and were brought down to under $10\frac{1}{2}$ crores by the end of March 1918. To add to these difficulties the news of the reverses sustained by the Allied armies in Europe brought a run upon the paper currency offices. Every ounce of silver that could be got hold of was poured into the mints, and the

thin flow of rupees was supplemented by an issue of sovereigns and gold mohurs. These measures, however, gave no relief, by the end of the first week in June the rupee balances dwindled to insignificance, amounting to little more than four crores, and the convertibility of the note issue hung in the balance. The complete suspension of rupee payments in a population of which 94 per cent was illiterate, at a time when the military situation was critical in Europe, would have been most disastrous for the credit of the Government, and would have given a serious set-back to India's war efforts.

In its hour of need, the Government of India turned to the U. S. A. the great storehouse of silver. In February 1918 Lord Reading, the British Ambassador at Washington, assisted by Sir James Brunyate, formerly Financial Secretary to the Government of India, represented to the Government of the U. S. A. the serious set-back which India's war efforts would receive from the suspension of specie payments, and appealed for assistance. The U. S. A. Government had been anxious about the payments in silver for their heavy purchases in India, and sold to the Government of India 8 million ounces of silver which helped to turn the tide. Far greater relief, however, was essential, and the U. S. A. government turned to the huge reserves of dollars held by it against its silver certificates. The Congress therefore passed the Pittman Act as a war measure of national importance, by which the Government

was authorised to withdraw the silver certificates and to borrow from the treasury the larger portion of its dollar reserve. India was to receive 200 million out of 270 million fine ounces to be obtained by melting down 350 million dollars. However, the solution of the problem regarding the price, which the Government of India should pay, proved difficult. Its representatives were unwilling to pay more than 85 cents per ounce, the price at which the annual production of the country could have been acquired. Many members of Congress, especially those belonging to silver-producing states, demanded that the old ratio value of \$1.29 per ounce should hold good. At last a compromise was arrived at, and it was decided to fix the price at a dollar per fine ounce, together with 1½ cent for mint charges, the U. S. A. Government thus receiving \$ 1.015 per fine ounce.

The news in India about the middle of April that the U. S. A. Government was arranging to help the Government of India relieved anxiety. By the beginning of July large consignments of silver under the Pittman Act began to reach India, the rupee balances began to improve, and by the end of September they rose to 12½ *crores*. With the advent of the busy season, however, the issue of rupees exceeded the coinage, and by the end of November the rupee balances fell to 8½ crores. But special measures were taken to increase the mints' production, and a system of double shifts was introduced with the result that towards

the end of February 1919 the rupee balances stood at 13 crores. In 1919-20 the issue of rupees in the busy season was substantially smaller, the output of the mints was large, there was no currency crisis, and at the end of February 1920 the rupee balances amounted to $14\frac{1}{2}$ crores.

Attention may now be directed to the part played by gold. The Fowler Currency Committee of 1898 recommended the establishment of a gold standard, with a gold currency and a gold mint in India. The Government of India at first endeavoured to carry out these recommendations, but meeting with the opposition of the Secretary of State and the English Treasury, it abandoned the efforts, and developed a gold-exchange standard, without a gold currency and a gold mint. Indian economists held that in India's interests the recommendations of the Fowler Committee should be carried out. The Government, however, expressed the opinion that the gold-exchange standard was the best for the country, that the circulation of gold would be wasteful, and that a gold mint was unnecessary. The Chamberlain Commission of 1913 gave its support to this policy. Before the war, therefore, the Government had fully committed itself to the policy of the continuance of the gold-exchange standard under which rupees and notes were the media of circulation, and the Government undertook the responsibility of converting this internal currency into international currency, namely gold and *vice versa* at a stable rate of exchange for the purpose of international

payments. The circulation of gold was checked as far as possible, on the ground that it was wasteful, and hence a gold mint was not required. The stress of war conditions, however, involved a twofold breakdown of the gold-exchange standard, and revealed the weakness of this policy. On the one hand, the Government could not fulfil its admitted responsibility of converting the internal currency into international currency and *vice versa* for international payments at a stable rate of exchange. On the other hand, it could not deal adequately with the problems of internal currency, there was a serious silver crisis of which neither the Government nor the Chamberlain Commission dreamt before the war, and the position would have become untenable but for the timely assistance of the U. S. A. The Government, therefore, turned to carry out the recommendations of the Fowler Committee, which it had rejected before the war, and which Indian economists had supported in vain.

In the early part of the war, the pre-war policy of taking measures to economise the issue of gold was continued. At the beginning of the war, as explained before, the issue of gold to private persons or firms was stopped. From June 1917 all imports of gold on private account were acquired by the Government under the Gold Import Ordinance, later converted into an Act, and were added to the Paper Currency Reserve, an equivalent amount of notes being issued to the importers. Again in 1917-18 under

an agreement betwen the Indian, Home and Japanese Governments, the Government of India received a part of the gold from the Indian and South African mines which had been stored in Bombay to avoid the submarine danger, and which belonged to the Bank of England, placed it in the Paper Currency Reserve, and issued an equivalent amount of notes to the represertatives of the Japanese Government in India. But, when the rupee balances began to be unduly strained, the Government of India had to abandon its general policy of discouraging the circulation of gold, and endeavoured to relieve the strain on the rupee balances during 1917 and 1918 by issuing sovereigns, selling gold bullion and taking steps for the establishment of a gold mint, as a large portion of the gold acquired under the Gold Import Ordinance and Act consisted of foreign coins and bars, and therefore could not be used for currency purposes. Sovereigns were issued chiefly in Northern India for the purchase of wheat and other agricultural products. Most of the gold bullion that was sold came from the remaining portion of the quantity that had been held in Bombay on behalf of the Bank of England, which was paid for it from the Reserve in London. The negotiations for a permission to open a gold mint in Bombay as a branch of the Royal Mint for the coinage of sovereigns were long drawn out. The British Treasury had opposed the proposal before the war, and even in the altered circumstances was not very favourable to it. Many difficulties had to be overcome, but the Government of India could not wait.

Therefore, it resorted to the temporary expedient of getting some of its gold coined into sovereigns in Australia on its behalf. An Act was passed in 1917, which was to continue for six months after the end of the war, and which provided that a part of the Paper Currency Reserve might be held in any part of the British Empire or in transit therefrom. This arrangement, however, proved troublesome, expensive and yet inadequate. Therefore, another temporary measure was taken. A distinctive Indian gold coin of the value of 15 rupees, the Mohur, was coined under an ordinance passed in June 1918 and later converted into an Act which was to continue in force for six months after the end of the war. The weight, fineness and size of the Mohur corresponded exactly with those of the sovereign. The only difference between the two coins was with regard to the designs which they bore. At last, all the difficulties in the way of the establishment of a branch of the Royal Mint in Bombay were overcome, sovereigns began to be coined from August 1918, and the further coinage of mohurs was stopped. The Royal proclamation establishing it did not mention any time limit, and in April 1919 the branch was closed, and the coinage of gold was suspended, on the ground of the difficulties in obtaining the necessary staff. All these devices for relieving the strain on the rupee balances and the straits to which the Government was reduced in achieving this object, showed the inability of the gold-exchange standard to withstand the strain of difficult times, at least so far as India was concerned.

The sovereigns issued by the Government immediately passed out of circulation. Nothing better could have been expected under the circumstances. The use of gold was bound up with the religious and social customs of the people, which could not be altered by any number of ordinances and acts. Yet during the war the country was almost starved of the yellow metal. Consequently, gold was at a considerable premium, and sovereigns became simply commodities, and not currency. Moreover during the war sovereigns were issued in a piecemeal fashion, without any definite and consistent policy, at those times when the apprehensions of the illiterate people had been aroused by the inability of the Government to meet the demand for rupees. Lastly, it should be pointed out that the absorption of gold coin and bullion during the war was far less than before the war. The following figures bring this out :—

[Table.

Absorption of gold coin and bullion in India in £ million.

	Average 1894-95 to 1898-99	1899-1900 to 1903-4	1904-5 to 1908-9	1909-10 to 1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
1. Product on in India	1.2	2.0	2.3	2.2	2.3	2.4	2.3	2.2	2.0
2. Imports	3.4	8.7	11.2	21.9	7.1	3.5	2.8*	17.9*	1.5*
3. Exports	1.9	4.5	5.0	3.1	2.0	4.3	0.1*	0.1	3.6*
4. Net imports (i. e. 2-3) ..	1.5	4.1	6.2	18.8	5.1	—0.7	2.8*	17.8*	—2.0*
5. Net addition to stock (i. e. 1—4)	2.7	6.1	8.5	21.0	7.4	1.6	5.1	20.0	..
6. Balance held in Mint and Government Treasuries and Currency and Gold Standard Reserves	0.4	8.6	4.4	12.7	10.4	8.4	8.1	17.9	11.6
7. Increase +or decrease—in stock held in Mints as compared with the preceding year	+0.4	+1.8	—2.2	+3.0	—4.6	—2.0	—0.3	+9.8	—6.3
8. Net absorption (i. e. 5-7) ..	2.3	4.3	10.7	18.0	12.0	3.6	5.4	10.2	6.3
9. Progressive totals of additions to stock	37.6	67.5	105.9	184.8	236.0	237.7	242.7	262.8	262.8
10. Net progressive absorption ..	37.2	58.9	101.5	172.0	225.7	229.2	234.6	244.9	251.2

N. B.—The quinquennial figures in items 1 to 8 are averages. Item 9 is the sum of the yearly figures in item 5 and item 10 the sum of the yearly figures in item 8.

* Excludes gold imported and exported on behalf of the Bank of England.

Table 29

Although dealings in sovereigns above their face value were prohibited from August 1918, the internal price of gold advanced, until in August 1919 it stood at Rs. 32 annas 12 per tola, on account of the absence of any substantial additions to the stocks of gold held by the public in India. In order to reduce this internal premium on gold and to pave the way to a return to a free gold market, the Government began, from August 1919, fortnightly sales of a part of the gold acquired directly and through private importers, from England, Australia and the U. S. A., after the restoration of freedom to the markets for South African, Australian and American gold, in the middle of 1919. The sales were continued till August 1920, and brought down the price of gold to Rs. 20 per tola, but when the sales were stopped, the price again firmed up, and stood at Rs. 28 per tola, towards the end of the year.

The absorption of gold and silver coin and bullion during the war gave rise to considerable adverse criticism on the part of some Western writers, who asserted that during the war India fully maintained its pre-war reputation for being, from the birth of international commerce, the receptacle or sink for the precious metals of the civilised world. Now, it must be admitted that before the war the absorption of the precious metals was considerable. This cannot be denied in the face of the facts that during the last twenty-five years the net imports of gold have been equal to the world's production for two years, and

that during the same period the imports of silver both on private and Government account have taken up the world's production for eight years. But, it is unfair to compare India with any of the Western countries in this respect, because the circumstances of the former are peculiar. If they are taken into account, India's so-called folly in the absorption of the precious metals will appear to be far less than it is usually made out to be. In the first place as Mr. Shirras points out, India has 15 times the area and 7 times the population of the British Isles. To cover this vast area and to meet the needs of this vast population large amounts of currency are naturally needed. Secondly, the means of communication in India are far less developed than in any western country. Therefore, the velocity of the circulation of its currency is much slower, and consequently much larger quantities of currency are required. Thirdly, it should be remembered that 94 per cent of the population is totally illiterate as compared with 1.6 per cent in Scotland, 1.8 per cent in England and Wales, and 17.4 per cent in Ireland. As mentioned above, the social and religious customs of the people are bound up with the use of the precious metals, and they can be altered only by the solvent of education and not by any number of decrees. Fourthly, India suffers from the almost complete lack of a banking system. Thus, the country, although possessing 15 times the area and 7 times the population of the British Isles, has only 93 per cent of the number of Banks, 4 per cent of the number of branches

and 6 per cent of the deposits, in the British Isles.* Every one living outside towns is his own banker, and whereas $\frac{4}{5}$ of the people in England and Wales live in towns, in India $\frac{3}{4}$ of the people live in the country. Added to this, the economic instability of the country owing to its almost entire dependence upon agriculture and the vagaries of the monsoon renders it necessary for the people to save against recurring periods of scarcity, and in the absence of a banking system, the saving can take the form of hoarding only. If the head of each household hides away only two rupees per annum per member, this would mean a hoarding of about 63 crores of rupees every year.

During war time the operation of these normal factors was supplemented by that of fresh and peculiar ones. In the first place, there was the most important factor in the shape of the huge disbursements of the Government of India, the effect of which has been already examined. Secondly, owing to the contraction of imports, the currency distributed in the country districts for the purchase of produce flowed back to the commercial centres to pay for the imports in much less quantities than in pre-war times. Thirdly, owing to the serious reduction of the import of gold and silver on private account till June 1917, and its prohibition thereafter, the precious metals necessary for ornaments were found by melting down coins. Lastly,

* See Shirras, Indian Finance and Banking, p. 10.

the depreciation of the paper currency in the country districts, made people more eager to obtain and keep metallic currency. However, in spite of all these factors, India's absorption of gold and silver coin and bullion, came to Rs. 165 crores during 1914-19 as compared with Rs. 224 crores in 1909-14.

The development of paper currency may now be examined. As explained before, the dislocation of trade, the loss of confidence and the panic resulting from the outbreak of the war brought about a run on the currency offices for the redemption of notes. However, the Government soon restored public confidence by cashing freely the notes presented, and even increased the facilities for encashment. The Chamberlain Commission had pointed out the possibilities of a rapid expansion of the circulation of notes by means of increasing the facilities for their conversion into rupees, and had recommended that the Government should increase, whenever possible, the number of places at which notes could be redeemed as of right, as well as the extra-legal facilities for encashment. Therefore, after the restoration of public confidence the Government revised its rules and regulations relating to the issue and encashment of notes at its treasuries, and laid down that every endeavour should be made to meet the requirements of the payee regarding the form of currency which he wanted, and that all applications for the exchange of coin for notes or *vice versa* should

ordinarily be met. Measures were taken to secure the convertibility of notes not merely at currency offices, but also at district treasuries and at many of the branches of the Presidency banks. These facilities were made real and effective by suitable arrangements for the supply of the necessary coin. The result was a phenomenal expansion of paper currency, which created a fresh record every year. The following figures show that the gross and active circulations between 31st March 1914 and 1919 increased by no less than 132 and 168 per cent respectively, and that they increased much further by31st March 1920:—

Circulation of notes In crores of rupees.

31st March	Gross circulation.	Notes held in Reserve Treasuries.	Net circulation.	Notes held in Government treasuries other than reserve Treasuries	Notes held in Presidency Bank head offices.	Active circulation.
1912	.. 61	5	56	3	8	45
1913	.. 69	13	56	3	6	47
1914	.. 66	7	59	3	6	50
1915	.. 62	6	56	3	9	44
1916	.. 68	4	64	4	7	53
1917	.. 86	4	82	3	12	67
1918	.. 100	2	98	4	10	84
1919	.. 153	3	150	4	12	134
1920	.. 174	..	173	..	..	154

Table 30.

In a country such as India, where the cheque is not likely to be used in the country districts for a long time to come, a steady increase in the circulation of notes is very desirable. Therefore, the expansion of paper currency as shown above was satisfactory so long as it was voluntary, backed by adequate metallic reserves, and freely convertible at its face value. But nothing is so dangerous as to force the pace of its expansion. This was what happened

in India from 1917 onwards, although she sinned against the light to a less extent than most other countries did. From that time her circulation of notes began to be inflated and became unhealthy. By that time, the Government had to make heavy military payments and other war disbursements, gold was unobtainable, silver was obtainable in limited quantities only, the rupee balances had become overstrained, the absorption of the precious metals had increased. The result was that the Government began the process of meeting a part of the expenses of the war by producing currency by means of the printing press. An official publication describes it as "a very rapid expansion in the country's readiness and capacity to utilise paper money."* In the first place, the circulation of notes ceased to be voluntary. The movement of the crops was now financed by means of notes instead of rupees, as had been the system thitherto. The cultivator had either to accept notes in payment of his produce or to allow it to rot in his fields. The Finance Member admitted that this process was not voluntary. Secondly, the facilities given in 1915 for the free encashment of notes in the district treasuries and branches of the Presidency banks were withdrawn. The rupee balances were concentrated in the head currency offices, where the redemption of notes was compelled by law, and to prevent the balances in these offices from being drawn out, the booking of specie by

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* Statement exhibiting the Moral and Material Progress of India 1919 p. 57.

rail and steamer and the transmission of it by post was made a legal offence. The notes thus became inconvertible except in the three Presidency towns. Later, in January 1919 even at the currency offices the daily issues of rupees to single tenderers of notes were limited to a figure which satisfied large demands only in part and only small demands as a rule in full. The usual consequences, namely the depreciation in the value of the notes followed. They could not be converted into rupees without an appreciable discount, especially in the country districts. The Finance Member admitted that this imposed considerable hardships upon the cultivators, who became more reluctant than ever to part with rupees, whenever they got hold of them, and this increased the currency difficulties of the Government. Thirdly, notes of Rs. 1 and 2½ were issued in December 1917 and January 1918 respectively, against the currency principle that the denominations of notes should not be low. Moreover, the notes were printed on very bad paper, with the result that agriculturists suffered a considerable loss, whenever they were damaged by water or destroyed by white ants and rats,—important considerations in India. The reluctance of the cultivators, therefore, to accept these small notes was greater, and their circulation to a substantial amount was simply the result of their being forced upon the cultivators. Fourthly, the metallic portion of the reserve against the notes continually diminished, while the invested portion increased. Before the war, the Indian paper currency

system was based upon the principle of the note issue of the Bank of England laid down by the Bank Charter Act of 1844, with the modification that the fiduciary issue was increased by the investment of a portion of the metallic reserve, when the proportion of the latter to the total of the notes in active circulation had shown, over a long period, a position sufficiently strong to justify an extension of the invested portion, and a corresponding reduction of the metallic portion of the reserve. At the outbreak of the war, the fiduciary portion of the reserve against notes was restricted to Rs. 14 crores, and for every note issued beyond this sum a corresponding amount of silver or gold had to be kept in the reserve. Now, whether the Bank Charter Act of 1844 imposed needless restrictions upon the note issue in England, or not, it appears that in India, where popular confidence in the note issue was not firmly established, the adherence to the principle underlying the Act was essential, to serve as a check to the inflation of paper currency. However, during the war it was abandoned, and the fiduciary portion of the reserve continually increased. It was this device, which chiefly led to the inflation of the paper currency, and made it in effect a forced loan from the Indian public free of interest. A number of Acts were passed, which, one after another, increased the permissible limit of the invested portion of the reserve.

[Table

Maximum limit of the fiduciary portion of the Paper Currency Reserve in crores of rupees.

		Permanent Investments	Temporary Investments	Total
Act VII of 1911.		14	..	14
Temporary amendment Act of	1915	14	6	20
,,	1916	14	12	26
,,	1917	14	36	50
,,	1917	14	48	62
,,	1918	14	72	86
,,	1919	14	86	100
,,	1919	14	100	114
,,	1920	14	106	120

Table 31.

The following table shows how far these powers were utilised, and also the position of the metallic reserve, and the composition and the location of the whole reserve.

Total note circulation and the reserve against it. In crores of rupees.

31st March.	Total Note circulation.	Silver	Percentage of silver to total reserve.	Gold India.	Gold England.	Gold Total.	Percentage of gold to total reserve.	Securities. India.	Securities. England.	Securities. Total.	Percentage of securities to total reserve.
Pre-war average (1910-14)	61.17	21.59	35	18.75	7.63	26.38	43	10.0	3.20	13.20	22
1915	61.63	32.34	52	7.65	7.64	15.29	25	10.0	4.00	14.0	23
1916	67.73	23.57*	35	12.24	11.92	24.16	36	10.0	10.0	20.0	29
1917	86.37	19.21†	22	12.0	6.67	18.67	22	10.0	38.49	48.49	56
1918	99.79	10.79	11	26.85	0.67	27.52	27	10.0	51.48	61.48	62
1919	153.46	37.39‡	24	17.37	0.12	17.49	11	16.08§	82.50	98.58	65
1920	174.52	39.85	..	44.36	3.45	47.81	..	20.30	66.56	86.86	50
War average (1915-19)	93.80	24.66	26	15.22	5.41	20.63	22	11.22	37.29	48.51	52

* Includes Rs. 51 lakhs worth of silver bullion held in England,
† ,, ,, 13 ,, ,, ,, ,, ,, ,, ,, ,,
‡ ,, ,, 504 ,, ,, ,, ,, ,, ,, ,, U.S.A. and in transit therefrom.
§ ,, ,, 608 lakhs worth of Indian Treasury bills.

Table 32.

The permanent invested portion of the reserve before the war consisted of Rs. 10 crores Government of India securities and 4 crores sterling securities. During the war, the investment in British Treasury bills came to no less than Rs. 81 crores. The Finance Member explained that this investment was the next best thing to the ear-marking of gold in London, which was considered impossible during the war in the interests of the Empire. However, the actual process, from the point of view of the inflation of currency, came to nothing better than this. The Home Government went on printing treasury bills and handing them over to the Secretary of State in payment of the war disbursements made on its behalf in India. Against these bills, the Government of India went on printing notes and issuing them to the public by way of the disbursements on behalf of the Home Government. The process cost both the Governments nothing beyond the cost of paper and printing. The result was that all limit to the inflation of the note issue was removed. Towards the end of the war the Government of India went further. Instead of depending upon the Home Government for the printing of the bills, which went to form its paper currency reserve, it began to print its own bills for this purpose. On the one hand, it printed bills and kept them, on the other, it printed notes and issued them, and the former formed the reserve against the latter. The investment of Rs. 6 crores of the Reserve in Indian Treasury bills in 1918-19 had simply this significance.

This process was continued in 1919-20, and currency notes were issued against investments in Indian Treasury bills, amounting to Rs. 3½ crores. Even the Finance Member deprecated the process. "None of us can pretend to any affection for that form of investment into which our necessities have recently forced us. I mean the purchase of our own Treasury Bills." To give an exact idea of the extent to which the process of increasing the fiduciary portion of the Reserve was carried on, it may be pointed out that it amounted to 366 and 647 per cent on 31st March 1918 and 1919 respectively, above the pre-war average. Its composition on 31st March 1919 was as follows :—

Investments of Paper Currency Reserve on 31st March 1919 in crores of Rupees

In England.	Amount	Purchase price.
2½% Consolidated Stock	1.50	1.28
British Treasury Bills	82.59	81.22
In India.		
3½% loan of 1842-3	8.16	8.0
3% loan of 1896-7	2.05	2.0
Indian Treasury Bills	6.40	6.08
Total	100.70	98.57

Table 33.

As a result of the increase in the fiduciary portion of the Reserve, its metallic portion went on diminishing until on 31st March 1919 it formed 35 per cent of the total reserve, as against the pre-war quinquennial average of 78 per cent. In addition to this remarkable

reduction, legislation had to be passed in September 1918 to enable the Government to regard silver held in the U. S. A. or in transit therefrom as a part of the metallic reserve. However, the composition of the Reserve improved towards the end of 1919-20, and on 31st March 1920, the metallic portion of the Reserve formed 50 per cent of the total Reserve, and, although the investment in Indian Treasury bills increased by Rs. 3½ crores, a reduction of Rs. 15 crores was effected in the holding of British Treasury bills. The composition of the fiduciary portion of the Reserve was as follows :—

Investments of Paper Currency Reserve on 31st March 1920 in crores of rupees.

	Nominal Value	Cost price
In rupee securities		
3½ per cent. loan of 1842-43	8.2	8.0
3 per cent. loan of 1896-97	2.0	2.0
Indian Treasury Bills	10.1	10. 0
In sterling securities		
2½ per cent. consols	1.5	1.3
British Treasury Bills	65.0	65.0
Total	86.8	86.3

Table 34

Moreover, the danger of making too much of the inflation of paper currency, which has been above dealt with, ought to be avoided. Therefore, in fairness to the Government of India it should be explained that in this respect it sinned against the light less than the Governments of most of the advanced countries

This fact is brought out by the following table :—

Notes in circulation of the World's Great Banks etc.*

	1919	£ million	Return just prior to war. £ Million	Increase £ million
Bank of				
Denmark	Sept. 30	25.312	8.693	16.619
England	Oct. 15	83.705	29.317	54.388
Currency Notes	Oct. 15	338.436	..	338.437
Total		422.141	29.317	392.824
Austria-Hungary	Sept. 23	1883.467	88.740	1794.727
Belgium	Oct. 9	187.718	64.594	123.124
France..	Oct. 16	1471.977	236.476	1235.50
Germany	Sept .30	1489.205	94.454	1294.660
Holland	Oct. 11	84.648	25.870	58.778
Italy	Aug. 31	414.091	66.445	347.646
Japan	Sept. 6	102.821	31.254	171.567
Norway	Oct. 7	24.468	6.608	17.810
Spain	Oct. 11	151.676	76.760	74.916
Sweden..	Oct. 11	39.540	11.456	28.084
Switzerland	Oct. 7	36.987	10.716	26.181
U. S. A.	Aug. 1st.	734.457	500.985	233.472
Total		7068.418	1252.539	5815.909

Table 35.

Having examined the growth of the rupee and paper circulation, we may proceed to consider the general aspects of the process of inflation, and its effect upon prices in India. The Federal Reserve Board of the U. S. A. defines inflation as "the process of making additions to credits not based upon a commensurate increase in the production of goods." But, the failure to reduce credits commensurate to a decline in the production of goods will produce the same effect upon prices. and should therefore be rightly described as inflation too. In most European countries, the production of goods decreased during the war, while the volume of the means of payment increased enormously.

* Spalding, Foreign Exchange and Foreign Bills, p. 223.

But the effect of the former cause upon prices, was far less than that of the latter, because, whereas the production of goods diminished by 20 or 30 per cent at the most, the total means of payment increased by 200 or 300 per cent at least. In the case of India, however, the production of commodities continued to increase during the war, as in the case of the U.S.A.* Mr. Shirras calculates that the production in India increased 30 per cent by 1919, as compared with the average figures for 1911-13.† Therefore, the effect of the increase in the means of payment in India upon prices was neutralised to this extent, and the above definition of inflation is adequate in this case.

In order to finance its own war expenditure and also that on behalf of the Home Government, the Government of India required sufficient means of payment. It secured them partly from higher revenues resulting from enhanced taxation and from loans, representing the actual savings of the community, and partly by an artificial creation of purchasing power. This latter method, in European countries took two forms, the issue of bank notes or state paper money for the benefit of the Government, and the creation of large bank credits in its favour, to be used as means of payment. The credits were transferred by government expenditure to the bank balances of the persons to whom they were paid. The total bank balances thus increased,

* See Fisher, Stabilising the Dollar, pp. 20-1.

† Indian Finance and Banking, p. 232.

and as the proportion between the payments made by currency and those made by cheque remains nearly the same over long periods, the customary ways of payment of a country altering themselves very slowly, the banks needed more currency to pay to their customers. The government had therefore to create more currency for the use of the banks, and the expansion of currency and bank credits went together. In India, the process was somewhat different. The Government possessed the monopoly of note issue, and this it used directly for providing itself with means of payment, while the more or less direct creation of bank credits in its favour was inappreciable.

Even the means secured by the government in European countries from taxes and loans did not all consist of real savings. The loans were sound so far as they were paid for by the savings of the investing public, but they led to inflation so far as they were subscribed to by banks or by the pubic with the aid of the advances made by the banks. High progressive taxes on income and capital, especially those levied on businesses, also caused inflation so far as they were paid with the assistance of the banks.* The war loans in India did involve some inflation, because a part of them was taken up by the banks and by their customers with their aid, and was paid for by means of bank credits. But, the increase in taxation does not appear to have brought about any inflation, because the increase was much less than in many European

* Dr. Cassel explains this fully in his memorandum to the International Financial Conference, 1920.

countries. The rates of the income tax and super-tax were much lower, and the excess-profit tax was levied only for a year in 1919-20, and they do not appear to have hit business firms so hard as to take away the profits urgently needed for the developments of the businesses, and to force them to seek the assistance of the banks for the purpose.

All this creation of the means of payment increased the buying capacity of the government, without taking away a corresponding buying capacity from the public. The total buying capacity in the country thus increased without a commensurate increase in the goods to be bought, and hence a general rise of prices resulted. This is the real and only cause of the rise in prices, and the other causes usually given are not independent, but are merely derived from this fundamental one. The following tables bring out the extent of its operation.

Net Absorption of Currency in Crores of Rupees.

	Pre-war Average 1909-10 to 1913-14	1914-15	1915-16	1916-17	1917-18	1918-19	1919-20
Sovereigns	10.99	7.48	-0.40	1.37	11.64	5.21	-3.30
Rupees and half-rupees	8.78	-6.70	10.40	33.81	27.86	45.02	20.09
Subsidiary coins	0.62	-0.21	0.36	0.97	0.99	2.78	0.51
Currency notes	3.39	-3.43	7.87	18.18	15.48	51.70	23.03
Total	23.78	-2.86	18.23	54.33	55.97	104.7	140.33

Note : — shows return from circulation.

Table 36.

Index Numbers* of the Growth in Circulation and Business. **

	1914	1915	1916	1917	1918	1919
Active rupee circulation † ..	101	110	114	122	118	123
Active note circulation ‡ ..	113	100	120	152	191	304
Cheque Currency (Bank clearings) § ..	92	96	138	154	239	..
Growth of business ..	113	112	117	124	126	130

* Average of the figures for 1911-13 being taken as 100.
† and ‡ On March 31st in each year.
§ During the whole year.

Table 37.

The real connection between inflation and prices does not appear to have been clearly understood by some economists. Mr. Shirras as well as the Finance Member, for instance, in explaining the expansion of currency refer to increased demands on the part of the trade and public for currency, owing to high prices of Indian produce resulting from increased demand for it from abroad.†† This would lead the uninitiated to conclude that the inflation of currency was a result of high prices, instead of being the cause. Now, it is true that when prices rise, the need for means of payment increases proportionally and that the amount of the media of exchange which can be kept in circulation is always proportionate to the general level of prices. But, prices cannot rise without a previous

** Shirras, Indian Finance and Banking, p. 232. In compiling this table, Mr Shirras appears to have made a mistake. He adds the rupees and notes in circulation on 31st March of each year to the amount of the bank clearing for the whole year, in order to obtain the total of the circulating media. The result is a figure which has no meaning, and which would possess significance only if the rupees and notes changed hands only once in a year,

†† Indian Finance and Banking, p. 15 and 56.

creation of artificial purchasing power. The actual process is this. When fresh purchasing power is placed at the disposal of a Government without a corresponding reduction in that in the hands of the people, a certain rise of prices must occur, in order that the equilibrium between the total purchasing power in the country and the commodities and services available for purchase, may be re-established. The public need of the circulating media will increase in proportion to the rise in prices which has taken place, and the amount just sufficient for this purpose will remain in circulation. A part of the newly created means of payment may return to the issuing authority, because the public has no need for it, but the artificial creation has already resulted in a rise of prices. If this operation is repeated, there will be a continual rise in prices, and a continual and proportional increase in the quantity of the media of exchange that can be kept in circulation. This is exactly what has taken place in India as in Western countries, and this is the true meaning of the public need of money of which Mr. Shirras and the Finance Member talk. But, it becomes evident that this need would not have arisen, if the general level of prices had not already been raised by an artificial creation of buying capacity.

Another reason given for the rise of prices in India is the influence of the conditions prevailing in Europe. " The intensive competition by belligerent countries for commodities

of all kinds, the diversion of huge numbers of those formerly engaged in production to the army and supply services; and the creation of a huge additional volume of credit and currency to finance the war, have led to an enhanced cost of production of practically all commodities. These conditions were bound sooner or later to re-act on India both by increasing the demand for her products, abroad, and by adding to the cost of the articles she imports.* This explanation is incorrect. The exchanges between two countries essentially depend upon the relative purchasing power of the money of both countries. If then, a general rise of prices has occurred in England, for instance, the value of the pound sterling in terms of rupees will be reduced in the same proportion, and with this new rate of exchange, the rise of prices in England cannot cause a similar rise in India. If only the supply of the means of payment in India had been kept sufficiently scanty, the purchasing power of the rupee would have remained unchanged, and altogether independent of any inflation and rise of prices in any other country. Yet another explanation of the rise of prices that is given is the high transport cost of and the restrictions upon imports. Such factors, however, can 'affect the general level of prices, only in so far as they bring about a reduction in the volume of commodities.

* Statement exhibiting Moral and Material Progress in India 1919 p, 63. See also the Report of the Currency Department 1919-20 p, 3, in which the same explanation of the rise of prices is given.

The actual rise of prices in India may now be examined. The official figures of the rise in average wholesale prices in respect of 61 articles of import and 50 articles of export, as compared with the pre-war year 1913-14 are as follows*:—

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	100	101	126	170	211	268
Exports	100	102	103	117	125	150

In 1919 the general unweighted index number for 28 exported and 11 imported articles was 193 as compared with 100 in 1913† By March 1920 the average wholesale prices in respect of the 11 chief articles of import fell to 250, and those in respect of the 28 staple articles of export rose to 170. At that time the general unweighted index number of the prices of the 28 articles of export and the 11 articles of import was approximately 210 as compared with 100 in the pre-war year.‡ Thus, by the beginning of 1920, the purchasing power of the rupee in commodities appears to have fallen to a little less than half of what it was before the commencement of the war.

At that time, the general level of prices in the U. S. A. which had resumed gold payments, and whose dollar therefore represented gold, was 217 as against 100 before the

* Review of the Trade of India, 1918-19.

† See the Index Numbers of Indian Prices 1861—1918 and the Addendum for 1919 to them.

‡ Compiled from tables of prices framed by the Finance Department of the India Office.

war.* Hence it seems that at that time there was little difference between the falls in the purchasing power of the rupee and of gold. No estimate, official or unofficial, of the rise in the cost of living of an agricultural or industrial worker is available. Indeed such an estimate, which would be true of the whole country is not possible, because conditions in this respect in the several parts of India, although tending towards unity, are still divergent enough to preclude any attempt at framing an estimate which would hold good for the whole country. Each estimate of the cost of living must be restricted to a particular district, and that is a task, which is beyond the scope of these pages. The above figures of the rise in the prices of exports and imports also must be used with caution and as representing in a fairly correct manner the general conditions prevailing in the country as a whole, and it should be borne in mind that the actual rise of prices in particular districts was likely to be appreciably more or less. However, some idea of the rise in the cost of living may be obtained from the fact that in 1919, the prices in the case of food-grains rose by an average of 93 per cent. since the beginning of the war, while those of piecegoods rose by 190 per cent. in the case of imported goods, and by 60 per cent. in the case of the goods manufactured in the country. These prices of imported and Indian made piecegoods make still more prominent the fact, which must have been noticed above, namely the marked

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* The level rising to 250 by July 1920, fell to less than 200 by the end of the year

difference between the rise in the prices of imports and exports. This feature, however, appears to have been more or less true of agricultural countries in general. For instance, the rise in the prices of the imports and exports of the Argentine Rupublic in 1919 was 309 and 170 respectively, as compared with 100 in the pre-war year. The forces of demand and supply operated to determine the relative prices of different commodities and services within the operation of the fundamental factor affecting the general level of prices, viz. the supply of total purchasing power in the country in relation to the supply of commodities and services to be bought. The supply of the former having increased without a commensurate increase in the supply of the latter, a rise in the geneal level of prices was bound to follow, but that rise was distributed in different degrees among the several commodities and services according to the operation of the forces of demand and supply*. In the case of the staples of export, the restrictions imposed upon exports partly by the shortage of tonnage and partly by the deliberate action of the Government, relatively affected the effective demand in an adverse manner, while the supply remained nearly the same. In the case of imports, the effective demand remained nearly the same, because most of the imports were essential for the social and economic life of the country, while the supply was considerably reduced on account of the shipping difficulties, and the concentration of the

* Cf, Fisher, Purchasing Power of Money pp, 174 ff,

war. * Hence it seems that at that time there was little difference between the falls in the purchasing power of the rupee and of gold. No estimate, official or unofficial, of the rise in the cost of living of an agricultural or industrial worker is available. Indeed such an estimate, which would be true of the whole country is not possible, because conditions in this respect in the several parts of India, although tending towards unity, are still divergent enough to preclude any attempt at framing an estimate which would hold good for the whole country. Each estimate of the cost of living must be restricted to a particular district, and that is a task, which is beyond the scope of these pages. The above figures of the rise in the prices of exports and imports also must be used with caution and as representing in a fairly correct manner the general conditions prevailing in the country as a whole, and it should be borne in mind that the actual rise of prices in particular districts was likely to be appreciably more or less. However, some idea of the rise in the cost of living may be obtained from the fact that in 1919, the prices in the case of food-grains rose by an average of 93 per cent. since the beginning of the war, while those of piecegoods rose by 190 per cent. in the case of imported goods, and by 60 per cent. in the case of the goods manufactured in the country. These prices of imported and Indian made piecegoods make still more prominent the fact, which must have been noticed above, namely the marked

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* Cf, Fisher, Purchasing Power of Money pp, 174 ff,

European manufacturing countries on the conduct of the war. Hence, it was natural that the general rise in prices resulting from inflation should affect the imports far more than the exports.

The rise in prices compelled a large part of the population, whose income did not increase proportionately, to curtail their consumption to a large extent, and to set free a certain mass of commodities, which the Government bought with the artificially created purchasing power in its hands. Hence the war expenditure of the Government was financed, as it was bound to be, by the real savings of the country, and therefore the inflation was undoubtedly an effective means of war finance. But the savings were in a large measure compulsory, and imposed considerable hardships, upon a large part of the population. Professor Pigou aptly described inflation as "a concealed income tax on all the citizens assessed without any allowance for family condition, distinction between earned income and investment income, or graduation of rates as between incomes of different amounts."* It is difficult to decide, whether the degree of compulsory savings was less in India than in the European countries. It is true that the rise of prices in India was much less, but it should be remembered that the pace of the rise of wages and salaries in the wake of the rise of prices was much slower also. However, the deciding factor seems to be that

* Memorandum to the International Financial Conference, 1920, p. 7.

only $\frac{1}{10}$ of the total population lives in towns, and that the monetary income of the remainder still forms only a part, although a rapidly increasing part, of its total income. Hence it appears that the hardships caused to the mass of the population by inflation as a means of war finance were substantially less in India than in most countries of Europe.

The immense hardships caused by the high prices to a large part of the population led the Governments of many European countries after the armistice to endeavour to keep down the prices of certain commodities and services below the level, which they would have reached otherwise, and to assist certain classes of people specially affected by the high prices. The various measures undertaken for this purpose were fixing maximum prices for certain products *e.g.* coal, sugar etc., regulation of rents, general subsidies for reducing the prices of commodities and services such as bread, coal and railway fares, charges to the public beneath cost in government undertakings such as post, telephone and railways, the sale of goods to the poor below cost, housing subsidies and unemployment allowances. The cost of these measures had to be borne by the Government or by certain producers and owners of goods. From the economic point of view, these measures were unsound. For, as M. Cassel points out, " uneconomically low prices on certain commodities keep the consumption of these commodities on an uneconomically high level and etard the necessary adjustments of consumption to the

limits prescribed by the available supply."* Government price regulations could not keep down the general level of prices, because the artificial restriction of some prices led to a corresponding increase of the unregulated prices. Moreover, the state expenditure on these measures was in many countries too large to be met by the proceeds of taxes and loans representing real savings, and therefore had to be met in part by a further inflation. Most of these measures were set aside in India, partly because their greater or less futility and the economic evils springing from them in Western countries had become evident, and partly because their operation would have been extremely difficult, and would have thrown enormous financial burdens upon the Government, in such a vast and diversely conditioned country as India. However, on account of the famine in 1918, the export of food-grains was prohibited, and this measure did check their prices from rising to the extent that they would otherwise have done. Rents were also regulated in a few capital cities, but the effect of this restriction in leaving to the consumer a greater buying capacity for other goods than he would have possessed in the absence of such a restriction, and thus raising other prices, must have been very slight, on account of the very small area in which the restriction operated, and the vastness of the country whose prices were to feel the effect. In M. Cassel's opinion this effect was considerable in Western countries.

* Memorandum to the International Financial Conference, 1920, p. 10.

CHAPTER IX.

Currency and Exchange. (*Continued.*)

Having examined in the preceding chapter, the main features of currency and exchange developments from the beginning of the war up to the issue of the report of the Smith Committee on Indian currency and exchange in December 1919, we may proceed to examine in this chapter, the policy pursued by the Government during the period of hostilities and after the armistice, the conclusions and recommendations of the Committee, and the action taken by the Government thereupon.

The currency and exchange difficulties were largely due to the fact that the normal flow of gold to India in adjustment of her favourable balance of trade was arrested during the war, on the ground of the necessity of concentrating the gold resources of the Empire. Private import of gold into India was forbidden, and India was made to accept payment for the vast quantities of war material shipped to the United Kingdom, in credits in London against which notes were issued in India, while, as shown in the chapter on Ways and Means, such payments to some other countries were made in gold to a large extent. The gold imports into India during the war were immensely reduceed as compared with those before the war, as explained before, and most of them even came from Japan and the U. S. A.

and not from the United Kingdom. Of all the countries which helped England in the prosecution of the war by providing war material, India was the least prepared to accept such deferred payments, taking into consideration her social and economic condition. The Government of India had to make huge disbursements on behalf of the Home Government by the issue of immense quantities of notes backed only by credits in London in the shape of Home Treasury Bills, which were unrealisable, and when the notes became practically inconvertible, and depreciated, the Government scrambled for silver in order to give some metallic cover to the note issue, and so raised its price against itself. This temporary and artificial inflation of the price of silver was considered a sufficient reason by the Secretary of State for raising the exchange value of the rupee higher and higher. Moreover, while England paid for a large part of its imports from the U. S. A. by floating loans there and by selling back the American securities, which it had held, no such efforts were made in India. It must be admitted that the response to such efforts would have been incomparable with that in the U. S. A., but an influential body of Indian economists believes that if the Government had resorted to a vigorous propaganda, and had given special facilities in connection with the floatation of Brit sh loans in India and the sale of Indian Government Railway and industrial securities held in England, the response on the part of India would not have been inconsiderable. The currency and exchange difficulties would have been largely avoided, if the Secretary

of State had insisted on behalf of India that all payments for her exports should be made in gold or securities acceptable to her. As the other nations were in urgent need of India's commodities for the prosecution of the war, they would have found the means of paying for them either in gold or in such securities. If this had been done, there would have been no necessity for India to purchase large quantities of silver at prices which soared higher and higher.

There might have been some reason for the pursuance of the policy of preventing the normal flow of gold to India during the period of the hostilities, but the continuance of the policy seems to have been quite unnecessary after the armistice, which crowned the allied arms with success, and especially after the middle of 1919, when the U. S. A. became a free market for gold, and the gold production of South Africa became available to the highest bidders in London. Yet, the same policy was continued for nearly two years after the armistice, although its rigour was somewhat reduced by fortnightly sales of gold on the part of the Government of India from August 1919. The private import of gold into India continued to be prohibited, and the acquisition rate for the gold imported into India was kept so low as to prevent gold from coming to India in substantial quantities.* The result was that the South

* When the quotation in the Indian bazaars for gold was Rs. 20 to the sovereign, the Government acquisition rate was Rs. 12 and annas 4½. See Smith Committee's report, Vol. II, p. 21.

African gold, for which India was the natural market, failed to go there, and that the diversion of gold from Egypt and Australia which used to take place before the war, was also prevented. The continuation of the legal prohibition of the free import of gold into India was all the more unnecessary, because a large part of the gold, which arrived in London every week, was allowed to go to the U. S. A., in adjustment of the debts due to them. This continuance of the restriction on the free movement of gold to India appears to have been opposed to the sound principle, which Sir Stanley Reed pointed out in his memorandum to the Committee, that every country had a right to determine for itself, at the time of making contracts, the form in which its debts should be paid.

Before proceeding to examine the silver policy of the Secretary of State, it may be mentioned that the desire to retain as much gold as possible is not restricted to the financial interests of any particular country, and that it prevails among these interests all the world over. But, it is not easy to understand why this worship of gold on the part of bankers and Governments should continue, when most economists have clearly explained its true function in the world economy, and when some of them maintain that as a consequence of the war the world has been suffering from a superfluity of gold.* It should be clearly borne

* Cf. Dr. Cannan's criticism of Mr. Shirras' paper on the prices of gold and silver in the Statistical Journal, July 1920, pp. 923-4 and M. Cassel's Memorandum to the Brussels Financial Conference.

in mind that the free flow of gold to India has been advocated in these pages, only as a means to the establishment of a sound currency and exchange system, and not from any belief in the intrinsic value of the process.

The defective gold policy of the Secretary of State explained above made an equally defective silver policy inevitable. Now, it should be made clear that the enormous rise in the price of silver during the last few months of 1919 and the early months of the succeeding year, was only partially due to the depreciation of sterling in relation to gold, and to that extent was unavoidable. This is easily seen from the fact that the rise in the price of silver did not reach its highest point at or even about the time when the depreciation of sterling was greatest, and that *mutatis mutandis*, the same was true of its lowest point. On the other hand, sometimes the price of silver fell when the depreciation of sterling as measured by the dollar-sterling exchange had increased and sometimes the opposite case also was true. The other element in the rise in the price of silver was the demand on the part of India and China, and the rise was avoidable so far as India's demand was concerned. The constitution of the silver market in London, where the purchases of the Secretary of State were made, was very narrow, the trade being principally in the hands of a small number of bullion brokers and merchants, whose main object was to manipulate the price of silver for their own profit to the

disadvantage of India, by anticipating her demands from the visible stock of rupees in India and any information secured through their connection with the India Office. The market was governed largely by visible supplies in London, a factor easily liable to manipulation. The continuance of the restrictions upon the free flow of gold to India and of the large sale of Council Bills made it necessary for the Secretary of State to purchase large quantities of silver. This action, together with the raising of the rate of exchange and making it closely dependent on the price of silver, excited the silver market in London with anticipations of continued purchases for Indian currency purposes at rising prices, and the silver interests tried to take full advantage of the situation brought about by these measures of the Secretary of State, by raising the price of silver. So far as the rise in the price of silver was due to this cause, it could have been largely prevented by the Secretary of State's withdrawal from the market, and especially by pursuing such a policy as to make clear to the silver interests that he would not purchase any silver unless its price fell to a more reasonable level. Moreover, there seems to be much truth in Mr. Dalal's contention that the price of silver would have climbed down still further, if the embargo on the export of silver had been lifted, and if the rate of exchange had not been raised, the rise in exchange producing the effect of lowering the rupee value of all the silver held in India, and making its exports unprofitable. If these conditions had been fulfilled, silver in large quantities would

have been exported from India to take advantage of the immense rise in the price of silver, and this would have lowered the price to a substantial extent. This belief is based upon the common knowledge that, in many parts of India, and among many classes, gold would be preferred to silver if it could be obtained at a comparatively cheap rate. The Government, however, could not permit the export of silver on account of the inflation of paper currency. Thus, one evil led on to another. The reserve of rupees against the inflated note circulation was small, and if the export of silver had been allowed, that reserve would have been depleted, the note issue would have become completely inconvertible, and even the semblance of convertibility could not have been maintained. However, if these measures had been taken by the Secretary of State, the price of silver would have fallen to, and its fluctuations would have been confined to comparatively narrow limits about, a level sufficiently low to enable the Secretary of State to stabilise the exchange value of the rupee at 1s. 4d. gold, and on the return of the dollar-sterling exchange to par, at 1s. 4d. sterling. The Smith Currency Committee was deeply influenced in framing its recommendations, by that provision of the Pittman Act, which laid down, that for the purpose of replacing the silver taken from its reserves, the U. S. A. Government must buy at the price of one dollar per fine ounce any silver produced within the U. S. A. and tendered to it for purchase. This led the Committee to conclude that the price of silver would not remain for

any length of time below one dollar per fine ounce for several years. But, this provision of the Act did not prove fully effective in keeping up the price of silver, which remained substantially below one dollar per fine ounce for many months after June 1920.,* and thus a large part of the basis of the recommendations of the Committee disappeared completely. The price of silver declined heavily after June 1920, fell as low as 40d. (sterling) at the beginning of December 1920. and for many months remained below 54d. (sterling) or 38½d. (gold)† per standard ounce. This was thus well below 43d. (gold) per standard ounce, at which the rupee could be minted without loss at the exchange value of 1s. 4d. (gold).

The heavy fall in the price of silver appears to have been due also to the appreciation of gold. As explained below, the purchasing power of gold in terms of commodities recovered appreciably during this period, without a similar recovery on the part of silver, and consequently the gold price of silver and also its sterling price declined. It appears that the Committee could have foreseen the operation of this factor, even if it could not foresee the probability, that the provision of the Pittman Act relating

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* Since May 1920 there have been two official quotations at New York, one at dollar one per fine ounce of silver produced in the U.S.A. under the operation of the Pittman Act, and the other below it for silver of foreign origin. See the Annual Financial Review of the Times, 28th January 1921, p. 28.

† During this period, the dollar-sterling exchange stood approximately at an average of 3.50 as against the par of 4. 86⅔.

to the purchase of silver would not be fully effective in keeping up the price of silver. It could probably have been foreseen that on the one hand, gold would appreciate in the immediate future on account of the endeavours of European countries to obtain it for the purpose of restoring some measure of stability to their chaotic currency and exchange conditions, and that, on the other, the demand of those countries for silver, for subsidiary coinage, would be much less, and that in the near future, the demands of India and China also would be largely reduced for some time, as they had become nearly saturated with silver, having absorbed very large quantities of it.* Thus, it seems that it was not impossible for the Committee to realise that the price of silver, which was very high when it issued its report, would fall substantially in the immediate future.

What course of action should the Secretary of State have pursued after the armistice? In order to understand it, it is necessary to emphasise two points. First, by the time of the armistice, the price of silver had risen to 49½d. only, also the exchange value of the rupee had to be raised to 1s. 6d. only, and the enormous rise in the price of silver and in exchange that took place, occurred subsequently. Secondly, internal currency stability appears to be more essential than external exchange stability, and any policy of subordinating entirely the former to the

* See Messrs. Montague's annual Bullion Report, 1920.

latter appears to be opposed to sound currency principles. For, as stated by Mr. Dalal, the legal standard for money payments should be regarded as less open to repeal or modification than any other legislative act, because the right which it gives to the people as to the kind of money they may demand in exchange for their goods or services, cannot be removed or modified without inflicting a grave and widespread injury, and because any change in the legal standard must seriously disturb the relations between debtors and creditors. The law determining the unit of value as the nucleous of all monetary contracts is to the individual's property rights what the Habeas Corpus Act is to the righs of the individual's person. Therefore the first aim of the Secretary of State should have been to maintain unaltered India's legal standard of the sovereign with rupees related thereto at the legally fixed ratio of 15 to 1, as far as possible. To achieve this object, the Secretary of State should have pursued a much more active gold policy. As the supposed necessity or facilitating the finance of the export of war materials from India had ceased after the armistice, he should have stopped all sale of Councils drafts and met his financial requirements out of the huge Indian assets, which had been accumulated in London, thus leaving India's balance of trade to be met naturally by the export of gold to it. This would have had the effect of largely reducing the necessity, for the Government of India, of paying out rupees. Then, he should have realised in gold India's huge investments

in the British Treasury Bills on behalf of the Paper Currency Reserve, by terminating them as they matured, or prior to it, by discounting them in blocks, and he should have transferred the gold to India. It is not suggested that large blocks of gold should have been sent out to India at once. The Secretary of State should have merely required that a substantial amount, say one million pounds worth of gold in sovereigns,should be sent to India regularly every week, out of the reserves of the Bank of England or out of the weekly arrivals in London, till India's assets in London were liquidated. In England the results of the adoption of these measures would not have been undesirable. The reduction of the central reserves would have tended to check the inflation of credit and the rise of prices, which would have tended to augment the flow of exports from England to the East to meet the outstanding balance, and thereby would have helped in the solution of exchange difficulties. Furthermore, measures should have been taken to prevent the export of gold produced in India, to secure it, and to facilitate the import of gold from South Africa by establishing a refinery in Bombay.

The Government of India should have sold the gold obtained by these means to the highest bidders, until its price in the Indian market had come down to the equivalent of Rs. 15 to the sovereign, and until sovereigns had reappeared in circulation. The unrestricted flow of gold

to India in adjustment of the trade balance would also have helped to bring about this result. Other results of this policy would have been that the Government would have received in India a large number of rupees in exchange for the gold thus sold, that, at the same time, the demand of the people of India for silver from outside India would have very largely disappeared, as they would have obtained the gold, which they were anxious to obtain, and that the Secretary of State would no longer have been compelled to purchase large quantities of silver at a high price, in order to endeavour to maintain the convertibility of the huge issues of paper currency in India. The Government of India should have utilised the gold bought from outside India, or the rupees received in exchange for it, to reduce the amount of notes outstanding. The continuance of this policy would have led to a diminution in the world's demand for silver, and to an increase in the world's effective demand for gold, and would therefore have tended to bring about a fall in the gold price of silver throughout the world. This process should have been continued till the price of silver fell to a level sufficiently low to enable the rupee exchange to be stabilised again at the old rate of 1s. 4d (gold).

Against the adoption of a gold policy in the interests of India, such as that outlined above, it has been argued that India is a bottomless sink for the absorption of gold, and that gold, once sent into India, is permanently lost to

the rest of the world.* The invalidity of this contention was pointed out in the preceding chapter, in relation to India's absorption of the precious metals generally, and the same conclusion becomes inevitable from an examination of the figures of India's absorption of gold before the war. India contains 19 per cent of the total population of the world, and therefore the consumption of less than 20 per cent of the world's production of gold on her part during the ten years preceding the war cannot be considered to have been a vicious habit. During 1890-1910 out of the world production of gold worth £ 1233 million, the United Kingdom, the U.S.A., Germany, France and Italy absorbed among them £ 773 million worth of gold, while the absorption of India, with a population not much less than the total population of all these countries, was only £ 126 million worth of gold. Moreover, of the total absorption of gold by the five Western countries, 60 per cent was absorbed for "other purposes", and only 40 per cent was added to the banking reserves. If 21 years' experience of popular tastes is worth anything, these figures do not place the most advanced Western powers in any better light than India in the matter of the absorption of the world's production of gold.† Even the Smith Committee had to make very important admissions in this respect. It admitted that the quantity of gold taken

* See, for instance, the evidence of the Governor of the Bank of England before the Smith Currency Committee.

† See Mr. Sarma's Memorandum, Report of the Smith Committee, Vol. III, p. 123.

by India for all purposes in the period before the war was not disproportionately large in relation to her economic conditions; that the normal balance of trade made India a creditor country, and thus entitled her to require payment for her produce in the form most acceptable to her people; that India's capacity to draw gold from other countries depended on the desire of her customers to secure her produce, and that so long as they continued to take it, India would be in a position to demand gold, in so far as she might prefer payment in this form, to the import of commodities or the investment in foreign securities of the credits due to her.

Proceeding to the findings of the Smith Currency Committee, the fundamental recommendations in its majority report may be summed up as follows :—(*a*) The suggestions for the issue of a new rupee with reduced weight or fineness, or of a 2 or 3 rupee coin of lower proportional silver content, or of a nickel rupee, and for declaring the notes inconvertible, should be rejected, and the rupee should remain unchanged in weight and fineness. (*b*) The relation between the rupee and gold should be stabilised at the rate of ten rupees to one sovereign, *i.e.* at the rate of one rupe to 11.30016 grains of fine gold, both for foreign exchange and internal circulation. (*c*) Council drafts should be sold by open tender at competitive rates, a minimum rate being fixed from time to time on the basis of the sterling cost of shipping gold to India, the rate

varying so long as sterling continued to be depreciated in relation to gold. Further the Government of India should be authorised to announce, without a previous reference to the Secretary of State so as to avoid delay, its readiness to sell weekly a stated amount of Reverse Councils, including telegraphic transfers, during periods of exchange weakness at a rate based on the cost of shipping gold from India to the United Kingdom, the rate again varying so long as sterling continued to be divorced from gold. (*d*) The import and export of gold to and from India should be free from Government control, as soon as the change in the statutory ratio between the rupee and sovereign was effected, and the gold mint at Bombay should be open for the coinage into sovereigns and half-sovereigns of gold tendered by the public. (*e*) The notification of the Government undertaking to give rupees for sovereigns should be withdrawn on account of the prevailing shortage of silver. (*f*) The prohibition on the private import of silver should be removed as soon as possible, and that on its export should be continued, until changed conditions again definitely established the rupee as an overvalued token coin. Mr. D. M. Dalal, the only Indian member of the Committee, held views fundamentally divergent from those of the other members, and submitted a separate report in which he recommended that the ratio of 15 to 1 existing then between the sovereign and the gold mohur and the rupee should remain unaltered, that as long as the price of silver in New York remained above 92 cents, the Government should

coin 2 rupee silver coins of reduced proportional fineness instead of the rupee, and that they should be unlimited legal tender.

The recommendations contained in the majority report of the Committee were accepted by the Secretary of State in Council as expressing the goal towards which Indian administration, following the previous policy, should thenceforth be directed, while the recommendations of Mr. Dalal were rejected as impracticable. Accordingly, in February 1920, a number of changes were made in the currency and exchange system then in force. The new relation of the rupee to the sovereign recommended by the Committee was put into force, for foreign exchange purposes, by fixing the acquisition rate for gold imported under license into India, which had till then been subject to variations notified from time to time, at ten rupees for each sovereign tendered for import or one rupee for 11.30016 grains of fine gold. Council drafts continued to be offered at the Secretary of State's discretion for a weekly sale by competitive tenders. No announcement was to be made of the minimum rate at which tenders would be accepted, and the Secretary of State reserved the right of rejecting the whole or a part of any tender. In accordance with the Committee's recommendations, the Government of India was to offer for sale when an occasion required it, stated weekly amounts of sterling reverse drafts on the Secretary of State, including telegraphic transfers. The rates

were to be announced on each occasion by the Controller of Currency, and were to be based on the sterling equivalent of the price of 11.30016 grains of fine gold as measured by the prevailing dollar-sterling exchange, less a deduction representing the charge of remitting gold. The new relation of the rupee to the sovereign could not be introduced for the purposes of internal circulation, so long as a great disparity continued to exist between the commercial price of gold in India and the recommended Indian mint par of one soverign for Rs. 10. Therefore, the old ratio of 15 rupees to the sovereign was to remain in force temporarily, until the disparity disappeared substantially. Till then, the import of gold was to continue to be controlled by license under the Gold Import Act with a fixed acquisition rate as mentioned above. However, the periodic Government sale of gold bullion to the public with a view to reduce the premium on gold was to continue and to be further developed under the same conditions as before, with the difference that the minimum limit of Rs. 23-14-4 per tola was withdrawn. Some of the other changes advocated by the Committee for internal purposes were also put into force. The Government notifications providing for the issue of rupees at the Reserve Treasuries in exchange for sovereigns and half-sovereigns, and regarding the receipt of sovereigns and half-sovereigns at the mints, were cancelled. The notifications under the Defence of India Act prohibiting the use of gold and silver coin otherwise than as currency or dealing therein at a premium were

also cancelled. The prohibition on the import of silver was withdrawn, and the import duty of 4 annas per ounce was abolished. The prohibition on the export of silver was maintained.

This action of the Secretary of State on the report of the Committee was followed by remarkable events. The Committee had been appointed to make recommendations for the establishment of a satisfactory monetary circulation and a stable gold-exchange standard. The immediate result of the acceptance of its recommendations was confusion, uncertainty and violent fluctuations, unparalleled in the history of Indian currency and exchange. Both the Committee and the Secretary of State-in-Council failed to realise the consequences of making the rupee-sterling exchange dependent upon the fluctuations of the dollar-sterling exchange, and of the undertaking to sell Reverse Councils on this basis. At the time when the Secretary of State took this action, a heavy slump occurred in the dollar-sterling exchange, the price of silver rose to the height of 89d. per standard ounce, and as a consequence of the above decision of the Secretary of State, the rupee-sterling exchange jumped from 2s. 4d. to 2s. 11d. and Reverse Councils had to be offered at the latter rate. The market rate failed to rise above 2s. $7\frac{1}{2}$d. and the exchange market became demoralised and disorganised. An unprecedented demand arose for Reverse Councils, and although a very large amount, at first £ 2 million, afterwards one million,

was sold every week, the supply fell far short of the demand. This was due to the fact that it was not a genuine trade demand, because the balance of trade was not unfavourable, and consequently there was no gap to be filled by sterling remittances on London. The demand was partly from speculators, who saw excellent opportunities of making huge profits by remitting large sums to London at this very high rate, and bringing them back to India when the rate should come down on the recovery of the dollar-sterling exchange as it was sure to do sooner or later, unless England were to become bankrupt, and partly from the English merchants and industrialists in India, who wanted to take advantage of this very favourable rate for transferring to England their profits, which had accumulated in India during the war. These large amounts of Reverse Councils were cashed in London out of the Secretary of State's cash balances and the Paper Currency Reserve. Thus, a large part of the assets, which India had built up in London during the war with great inconveniences at the rate of fifteen rupees to the sovereign, was brought back to India at the rate of less than $7\frac{1}{2}$ rupees, thus involving a loss of 35 crores of rupees to the Indian treasury. This continued sale of large amounts of Reverse Councils involved a number of other disadvantages.* It created an intense instability and caused violent fluctuations in the rupee-sterling exchange because of the extraordinary

* See the Annual Financial Review of the Times, 28th January 1921, p. 41.

instability of the dollar-sterling exchange and thereby considerably dislocated trade and finance. It led to a complete divorce between the official and market rates of exchange. It caused a considerable tightness in the money market by taking off the market large sums of money with the result that the rate of discount rose to 11 per cent at a time of the year when the busy export season was at its height. The Government endeavoured to check speculation, but was not successful. The Government also tried to alleviate the stringency in the money market by making available to it through the Presidency Banks, a part of the sums obtained by the sale of Reverse Councils, which should have been added to the Paper Currency Reserve in India against corresponding withdrawals in England, but for which were substituted Indian Treasury Bills in accordance with the powers obtained from the Legislature. This sale of Reverse Councils on a large scale and at a rate constantly fluctuating with the fluctuations of the dollar-sterling exchange continued till June 1920, when the dollar-sterling exchange recovered considerably, the price of silver declined to 52d., the rupee sterling exchange also fell considerably, and the market rate remained near 1s. 10d. Hence, at the end of June 1920 the Government had to abandon its attempt to put into force the fundamental recommendation of the Currency Committee, namely the stabilising of the exchange value of the rupee at 2s. gold, fixed the rate for Reverse Councils at 1s. 11 $\frac{1}{32}$d. per rupee, and thus made it independent of the

fluctuations in the dollar-sterling exchange. Then a moratorium of three weeks was allowed to enable holders of sovereigns to tender them to the Government Treasuries at the ratio of 15 rupees to the sovereign. At the end of the period, the restrictions on the import of sovereigns were withdrawn, but sovereigns ceased to be legal tender, until an act was passed in August by the Legislature making them legal tender at the ratio of ten rupees to the sovereign. Although the disparity between the commercial price of gold in India and the mint par of Rs. 10 to the sovereign recommended by the Committee was still substantial, these measures were rendered urgent by the illicit import of sovereigns smuggled across the land frontiers of British India for encashment at Government Treasuries. In October the Government of India had to stop the sale of Revers Councils altogether, because, although the total sale by this time had exceeded £ 55 million, it had failed to produce any appreciable effect in the direction of stabilising exchange at 2s. gold or sterling. Upon the withdrawal of the Government from the market, its rate fell considerably, and in the early part of 1921 remained in the neighbourhood of 1s. 3½d. (sterling), the sterling price of silver also reaching its lowest level at that time.

The fundamental recommendations of the Smith Currency Committee were based upon three conclusions, namely that a high level of exchange was essential for the establishment of a sound monetary system in India,

that a high level of exchange was advantageous to India on social and economic grounds, and that the balance of advantage lay on the side of fixing the exchange value of the rupee in gold rather than in sterling.

The first conclusion was based upon an examination of the probable trend of the price of silver in the near future. From a perusal of the report on the world's production of silver by Professors Carpenter and Cullis, and from an examination of the probable effects of the provision of the Pittman Act relating to the purchase of silver, the Committee decided that for some years the price of silver could not be expected to fall below one dollar per fine ounce. As regards the maximum beyond which the price of silver was unlikely to rise, the prices of silver at which the silver coinage of the more important countries had a bullion value equal to their nominal value, exchanges being at par, were England 66d, France 60¾d. and the U. S. A. 59¼d. When the price of silver was 137.8 cents per fine ounce, corresponding to 62.9d. (gold) per standard ounce, and well above the French and American parities, the corresponding bullion value of the silver in the rupee was 1s. 11.36d. (gold), and the cost of the rupee including all charges was 2s. (gold). The committee therefore believed that the rupee could be established as a token coin, and that a satisfactory monetary circulation in India cound be maintained, if the exchange value of the rupee was fixed at a level not lower than 2s. (gold).

As regards the second conclusion, the Committee expressed the view that, although India was a country whose export trade was more valuable than her import trade, the rise of prices in India was injurious to the country as a whole. The Committee therefore decided that any measures tending either to reduce prices or to check a further advance in them would be beneficial to the country as a whole, and that the fixing of the exchange value of the rupee at a high level was an important measure to achieve this object, as it would lower the values of India's imports and exports as measured in rupees. It was true that high exchange could have little direct effect on the prices of the exported produce of which India possessed a practical monopoly, and of the produce almost entirely consumed within the country, but the Committee thought that the indirect effect would give a similar result, though to a less extent.

The Committee, however, had to examine the probable effects of a high level of exchange upon India's trade and industries. It believed that the effects of a rise in exchange in encouraging imports and checking exports were transitory, and did not continue beyond the period necessary for wages and other element of cost to adjust themselves to the new conditions. Moreover, Indian trade was prosperous and in a position to maintain it, during the period of adjustment, on account of the continuing intensity of demand for raw materials and food-stuffs grown in

India, resulting from their world shortage, while the great rise of prices in the countries importing from India would enable the Indian producer to obtain a satisfactory rupee price for this produce, notwithstanding a high level of exchange. The Committee therefore expressed the opinion that Indian trade was not likely to suffer any permanent injury from fixing the exchange value of the rupee at a high level, with this important qualification, however, that, if a great and rapid fall in world prices were to take place, so as to check Indian exports, on account of the failure of the costs of production in India to adjust themselves with equal rapidity, to an extent which would endanger the maintenance of the high exchange, the problem should be considered afresh, and measures to suit the altered conditions should be taken. With regard to the probable effect of a high level of exchange on Indian industrial development, the Committee believed that even during the period which may elapse before prices and other conditions were completely adjusted to the new level, the temporary stimulus to competitive imports given by the high rates of exchange would be counteracted by the greatly increased cost of production in the exporting Western countries. Moreover a high exchange would retain for Indian industries, the advantages of a low cost for wages, raw materials and imported machinery, plant and stores. Therefore the Committee was of opinion that Indian industrial development would not be seriously hampered by a high rate of exchange.

As regards the third conclusion of the Committee, the question arose because the complete convertibility of sterling into gold, which existed before the war, had disappeared, gold coins had ceased to circulate in the United Kingdom, the notes were not in practice convertible into free gold, and consequently the pound sterling had depreciated in relation to gold. The main argument for retaining the fixed relation of the rupee with sterling was that a larger part of India's trade was with the sterling-using British Empire than with countries with an effective gold standard. The Committee, however, did not think that a fluctuating rupee-sterling exchange would create any serious obstacle to trade between India and the British Empire, provided that trade requirments for remittance were met readily and fully. On the other hand, the disadvantages of fixing the exchange value of the rupee in terms of sterling were great. Firstly, if the rupee were to be linked to sterling, it would share with sterling all the great inconveniences attaching to a depreciated currency. Secondly, the possibilities of further advances in the sterling price of silver due to a further depreciation of sterling increased seriously the difficulties of fixing a sterling value for the rupee which could be maintained with certainty. Thirdly, if at some future time sterling recovered its value and again became equivalent to gold, the high sterling value for the rupee, which would have to be fixed under the conditions prevailing at the time, might be found too high, since that value would have

increased in relation to gold and other commodities. Fourthly, if the relation of the rupee to sterling were fixed, its relation to gold would vary so long as sterling varied in relation to gold. But as the Committee considered it essential that both the rupee and the gold sovereign should circulate freely as unlimited legal tenders, it was necessary that the relation between the two should be fixed.

It is difficult, however, to accept these conclusions of the Committee, as it ignored several vital factors in arriving at them, and as, in addition, the weakness of its reasoning has been disclosed by later events. This is the case with regard to the first conclusion, because it has already been shown that it was practicable at that time to establish a comparatively satisfactory monetary system in India with the exchange value of the rupee no higher than the old level of 1s. 4d. (gold), by pursuing a well-conceived currency policy. In the early part of 1921 exchange fell considerably, and remained in the neighbourhood of 1s. 3¼d. (sterling). But during this time, the normal rate as determined by M. Cassel's formula explained below, was in the nighbourhood of 1s. 7d., and if the Government had not wasted any part of its resources in a futile attempt at stabilising exchange at 2s. (gold), and if it had supported exchange during this period by selling reverse councils at 1s. 7d., it is probable that exchange could have been prevented from falling below 1s. 7d. (sterling) and 1s. 4d. (gold).

Moreover, it is surprising to find that the Committee, although taking into consideration the depreciation of the dollar-sterling exchange, paid no direct attention to the relative purchasing powers of the rupee and pound sterling in terms of commodities, and no attention at all to those of the rupee and gold, *i. e.* to the general price levels in India, the U. S. A. and the United Kingdom, because this was the fundamental consideration in finding out the normal rate at which exchange could be stabilised and a sound monetary system could be established. Recently, M. Cassel has taken much pains to draw the public attention to this vital factor in the stabilisation of international exchanges.* "Our willingness to pay a certain price for a foreign money must ultimately and essentially depend on the fact that this money has a purchasing power as against commodities and services in the foreign country. On the other hand, when we offer so and so much of our own money we offer, in fact, a purchasing power against commodities and services in our own country. Our valuation of a foreign money will, therefore, essentially depend on the relative purchasing power of the currencies of both countries. Given a normal freedom of trade between two countries, A and B, a rate of exchange will establish itself between them, and this rate will, smaller fluctuations apart, remain unaltered as long as no alterations

* See his articles in the Economic Journal, the Annals of the American Academy May 1919 and Memorandum to the International Financial Conference. The Theory, however, was originally emphasised in the Bullion Committee's Report.

in the purchasing power of either currency is made and no special hindrances are imposed upon the trade. But as soon as inflation takes place in the money of A, and the purchasing power of this money is, therefore, diminished, the value of the A—money in B must necessarily be reduced in the same proportion..............Hence the following rule: when two currencies have been inflated, the new normal rate of exchange will be equal to the old rate multiplied by the quotient between the degrees of inflation of both countries. There will, of course, always be fluctuations from this new normal rate, and in a period of transition these fluctuations are apt to be rather wide. But the rate calculated in the way indicated must be regarded as the new parity between the currencies. This parity may be called the purchasing power parity, as it is determined by the quotient of the purchasing powers of the different currencies."*

This passage shows that the most scientific way for the Committee in determining the rates of exchange between the rupee, gold and pound sterling would have been to be guided by their relative purchasing powers. The purchasing power parity between the dollar and the rupee would have given the Committee the truly normal rate of exchange between gold and the rupee, because, free gold payments having been resumed in the U. S. A.,

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* Memorandum to the International Financial Conference, 1920, p. 15.

the dollar represented gold. Now, it has been already explained in the previous chapter, that at the time when the Committee formulated its recomendations, the rise in the general price levels in the U. S. A. and India *i.e.* the fall in the purchasing power of gold and the rupee was nearly the same. Therefore, the purchasing power parity between gold and the rupee at this time was approximately the same as that in force before the war, and consequently the most scientific and quickest way of stabilising exchange was to endeavour to do so at the old level of 1s. 4d. (gold) to the rupee. It is true that even at this time the fall in the purchasing power of gold was slightly higher than that of the rupee, and that a strict adherence to the theory would have required a slightly higher exchange rate. But, as explained above, there were most valuable advantages in maintaining the old rate as far as possible, and it would not have been very difficult to stabilise exchange at that rate by pursuing the policy outlined above. At any rate it becomes clear that the rate recommended by the Committee, *viz.* 2s. gold, was not warranted by the purchasing power parity between gold and the rupee, and that it was futile to endeavour to stabilise exchange at this rate. In fact, as explained before, this attempt failed completely and had to be abandoned.

It is true that the purchasing power of gold fell further during 1920, on account of the further influx of gold into the U. S. A. But, it appears that this fall would not have

occurred, if gold had been allowed to flow freely to India, and if thereby the effective demand for the world's gold had been allowed to increase. Moreover, it seems that the whole of this depreciation of gold will not last in the immediate future. The European countries will endeavour to strengthen their central holdings of gold, although they may refrain from reintroducing gold circulation. In fact, the Bank of England has been attempting to acquire more gold. This will increase the world's demand for gold, and consequently its value. It is true that economists like M. Cassel emphasise the great need of a close co-operation on the part of the principal countries of the world in the form of an international agreement, to secure that countries in a position to draw gold to themselves from the rest of the world should abstain from doing so, in order that the prevailing value of gold in relation to commodities may be stabilised. But, it seems that it is futile to expect the close co-operation essential for the purpose, if the enormous difficulties of forming and successfully working international monetary agreements, evident from past experience, and the worship of gold on the part of bankers and Governments that prevails in all countries, are taken into account. It will be extremely difficult, if at all possible to induce any country possessing the power to draw gold to itself from the rest of the world, to refrain from doing so in the immediate or near future. It is very probable, therefore, that gold will recover some of the

purchasing power which it has lost.* If, ultimately, the proportion in the reduction of the purchasing power of gold as compared with the power before the war becomes less than the similar proportion in the case of the rupee, the exchange value of the latter will sink even lower than 1s. 4d. gold. But, it is unlikely that the purchasing power of gold will recover in the near future so far as to become much more than half of that before the war. For, the actual circulation of gold is not likely to be resumed in the near future, and as the ecconomic conditions in several European countries are unsatisfactory, their central banks will not be able, for some time to come, to regain fully their pre-war power of attracting and keeping gold. It is also improbable that the rupee will reach much more than half of its pre-war value in commodites, because the possibilities of deflation, as explained later, are limited. On the whole, it is probable that, in the near future, the positions of the purchasing powers of gold and the rupee as compared with those before the war will be nearly the same, and that the normal rate of exchange between them will be in the neighbourhood of 1s. 4d. gold.

Similarly, the normal rate of exchange between the rupee and the pound sterling depends upon their relative purchasing powers, *i. e.* upon the general price levels in India and the United Kingdom. Applying M. Cassel's

* This is what actually occurred. The purchasing power of gold reached its lowest point in the middle of 1920, and afterwards kept recovering steadily.

formula given above, it is found that when the Committee reported, the normal rupee-sterling exchange was in the neighbourhood of 1s. 10 d. (sterling) and that in the early part of 1921 it was in the neighbourhood of 1s. 7d. (sterling). This rate cannot be permanent, because England is trying her utmost to establish parity between the paper pound sterling and the gold sovereign, and economists such as Professor Pigou and M. Cassel believe it to be practicable. When this object is attained, the rupee-sterling exchange and the rupee-gold exchange will be equivalent, as was the case before the war.

The second conclusion also of the Committee, that a high level of exchange was advantageous to India on social and economic grounds, cannot be accepted. The main reason, which led the Committee to come to this conclusion, was that high exchange would produce the effect of checking the rise of prices in India. It has already been explained that this rise was due primarily to the inflation of currency brought about by the over-issue of notes on the part of the Government. The remedy for checking the evil of the rise in prices should therefore have been sought in curtailing the operation of the cause which brought about the evil, namely in contracting the note issue. In spite of a high level of exchange, the progressive rise in prices would have continued if the operation of the cause which produced it was allowed to continue. It is difficult to understand, why the Committee ignored almost completely this fundamental

cause of the Indian currency and exchange troubles. This action of the Committee was in strong contrast to that of the Cunliffe Currency Committee, which clearly pointed out the existence of the evil in England, although opinions may differ as regards the efficacy of the remedies it proposed. Moreover, although high exchange may have the effect of checking the rise in prices, and low exchange, of fostering it, so far as economic theory goes, it is doubtful whether its actual effect will be substantial in the peculiar conditions of India, where the force of custom is still more powerful and the play of free competition less so, than in the West, and where the currency, instead of being free and automatic, is managed by the Government at every stage and in every detail. These doubts are strengthened by past experience, which is revealed by the following figures:—

Year	Index Numbers for prices of food-grains.	Exchange.
1873	100	23d to the rupee
1894 ..	114	13d ,,
1912	189	16d ,,

Table 38.

It will thus be seen that although exchange fell by as much as 10 d. between 1873 and 1894, the prices of foodgrains rose by 14 points only. Then, although exchange rose only by 3d. between 1894 and 1912, the rise in the prices of food

grains was 75 points, prices in the United Kingdom on a gold basis rising only by 20 points during the same period.

The Committee admitted that a rise in exchange had the effect of encouraging imports and checking exports, but it maintained that this effect was transitory, and did not continue beyond the period necessary for wages and other elements of cost to be adjusted to the new conditions. This is correct in theory, and it is difficult to agree with the the contention of Indian export merchants that their trade would be permanently and altogether ruined by high exchange. But, the process of adjustment, upon which the Committee relied so much, will be difficult even in the Western countries, and in the conditions of India, mentioned above, it will be particularly difficult, and the period of transition will be necessarily prolonged, during which India's export trade, which is much more important than the import trade, may suffer a considerable injury, and the balance of trade may be so affected as to disturb the monetary system established in accordance with the recommendations of the Committee.* That the Committee was aware of the existence of these difficulties will be seen from the important qualification which they added, that if a great and rapid fall in world prices were to take place so as to check Indian exports, on account of the

* This is what actually occurred during 1920. The setback to India's exports during that year appears to have been partially due to high exchange.

failure of the costs of production in India to adjust themselves with an equal rapidity, measures to suit the altered conditions, implying the lowering of the exchange value of the rupee, should be taken. In these matters, western standards are not yet fully applicable to India, and the play of natural economic forces is slower in India than in the West. The same considerations apply to Indian industrial development. They, however, apply to a greater extent, because most of the Indian industries are new, being started as a result of the war, are suffering all the disadvantages that spring from a lack of experience, and possess no secure markets, even the Indian market being in the grip of foreign competitors. These competitors themselves have admitted that the rise in exchange helped them a good deal, and no better evidence of it can be found than in the report of the United Kingdom's Trade Commissioner in Calcutta, on the prospects of British Trade with India. This would more than wipe out the indirect advantages which, in the opinion of the Committee, the Indian industries might derive from high exchange. Moreover, it is significant that the Committee merely expressed the view that Indian industrial development would not be *seriously* hampered by a high level of exchange, tacitly admitting thereby that it would be hampered to some extent. But, as the development of Indian industries has been emphasised upon, in the preceding pages, as one of the most vital steps in India's economic advance, it seems that any policy, which tends to hamper that development to any

extent, must be regarded as detrimental to India's economic interests.*

With regard to the third conclusion of the Committee that the balance of advantage lay on the side of fixing the exchange value of the rupee in gold rather than in sterling, it was seen above that its acceptance by the Secretary of State, instead of producing stability, led to confusion and violent fluctuations in exchange unparalleled before. The Committee as well as the Secretary of State could probably have foreseen the undesirable consequences of making the rupee-sterling exchange entirely dependent upon all the fluctuations and fortunes of the dollar-sterling exchange, and of the undertaking to sell Reverse Councils on this basis. India's economic relations with sterling-using countries were far more important than those with countries on an effective gold basis, and it was the fluctuation of the rupee-sterling exchange, which mattered most for India, and which the Committee was appointed to remedy. If the Committee wanted to make the rupee worth 2s. when the pound sterling again became equivalent to the sovereign, it should have recommended that, during the continuance of the depreciation of sterling, the Secretary of State should endeavour to stabilise the rupee-sterling exchange at some higher level, say 2s. 10d., determined

* It should be clearly borne in mind that there is no permanent or intrinsic merit in a low, or demerit in a high, level of exchange, and that any such conclusion from the above line of argument would be entirely erroneous.

after taking into consideration the average sterling depreciation, by selling Council drafts in London and Reverse Councils in India at that rate, when exchange tended to rise above or fall below it, and that he should ultimately bring it down to 2s. by lowering it gradually by two pence at a time, along with a definite reduction and ultimate disappearance of the sterling depreciation; but it is very doubtful whether efforts in this direction for stabilising exchange would have succeeded, because the level chosen, namely 2s. gold, was too high. The best chances of stabilising the rupee-sterling exchange appear to have been afforded at that time by an endeavour to do so at the rate of 1s. 10d. by the above method, so as to bring it down ultimately to 1s. 4d. when the pound sterling should again become equivalent to the sovereign. Thus, all these considerations seem to show that it was neither necessary nor desirable to fix the exchange value of the rupee at 2s. (gold), the rate recommended by the Committee. Moreover, if it did not see its way to recommend a rate lower than 2s. (gold), the wisest policy for the Government would probably have been to fix no rate, but to go on as before, till times became more normal, the temporary disturbances sufficiently worked themselves out, and the price of silver became more stable. All other considerations were subordinated by the Committee to that of the stability of exchange, but even this advantage was not secured, when its recommendations were put into force. And even if it had been secured, the same query might

have been put to the Babington Smith Committee, which was put by Professor Nicholson to the Chamberlain Commission. "In all the various changes the dominant force has been the stability of the foreign exchange value of the rupee in relation to gold. If this is secured, does it follow that all the other functions of good money are fulfilled by the rupee as so managed ? "

The other recommendations of the Committee may now be considered. Their view that Council drafts were being sold not for the convenience of trade but to provide for the Home Charges was thoroughly sound, but it is difficult to accept its recommendation that there would be no objection to the sale of drafts on the part of the Secretary of State in excess of his immediate requirements, when a trade demand for them existed, due regard being paid to his convenience and the proper location of the reserves, because such a sale would tend to economise the movements of gold. It has been explained before that the sale of Council drafts has the effect of diverting the payment of India's balance of trade from gold to silver. In all other countries, the requirements of trade are fully met without any active intervention on the part of the Government in the shape of the sale of Government bills. In all other countries, the Governments merely provide machinery for coinage, and leave it to its own automatic action, excepting the provision of subsidiary coins. There seems to be no reason why India's trade

should be conducted on lines different from these. It is most desirable that the Indian currency and exchange system should be left to its own free and automatic action as far as possible, and therefore, as Mr. Dalal recommended, the sale of Council drafts should be restricted to the amount defined in the Indian budget as required to be remitted to the Secretary of State.

It is noticeable that, although the Smith Committee agreed with the Chamberlain Commission that the currency most suitable for the internal needs of India consisted of rupees and notes, and that it would be to India's advantage to keep gold in Government reserves available for foreign remittance and not in circulation, its recommendations regarding the gold question were more liberal than those of the Chamberlain Commission, and were a substantial step in the direction of allowing India an unrestricted use of gold, essential for establishing a sound monetary system. The Committee's attitude and recommendations in respect of the silver problem were also sound.

In the matter of the Paper Currency Reserve, in order to introduce some elasticity into the paper currency system, and to obviate the necessity for constant fresh applications to the Legislature to be allowed to increase the amount of the invested reserve as the circulation grew, the Committee recommended that the system, under which the

invested portion of the reserve must not exceed a fixed maximum, should be replaced by the regulation that the metallic portion of the reseve must not fall below a minimum percentage of the total issue, and suggested 40 per cent of the gross circulation as the suitable minimum. As regards the composition of the invested portion of the reserve, the Committee recommended that the amount to be held in Government of India securities should be limited to Rs. 20 crores, the amount permissible under the temporary legislation then in force, and that the balance should be held in securities of other Governments within the British Empire. Of this amount, not more than Rs. 10 crores might be invested in securities, redeemable at a fixed date, but with more than one year's maturity. The remainder should be held in securities redeemable within a year. However, in view of the difficulty of maintaining in the immediate future such a large proportion of the reserve in metal as 40 per cent, the Committee saw no objection to the retention, for a limited period, of the permissive maximum of Rs. 120 crores existing at the time for the fiduciary portion of the reserve. As to the location of the reserve, the suggestion was that, as it existed primarily for the redemption of notes in India, the gold and silver in it should be held there except for temporary purposes, such as awaiting shipment. To meet the seasonal demand for additional currency, the Committee, in addition to the elasticity in the note issue provided by the above recommendations, further

recommended, as an experimental measure along the lines of the Federal Reserve Note system in the U. S. A., the issue of notes up to Rs. 5 crores as loans to the Presidency Banks at a rate of interest not less than 8 per cent, on the security of export bills of exchange maturing within three months.

These recommendations were accepted and were incorporated, with some changes, in the Currency Act 1920, which prescribed the permanent constitution of the Paper Currency Reserve, to be established ultimately, and the temporary arrangements to be made until effect could be given to the provisions relating to it. With regard to the former, the Act laid down that the metallic portion of the reserve should be 50 instead of 40 per cent of the gross circulation, and that not more than £ 5 million of it might be held in England, this sum being regarded as sufficient to cover the value of gold purchased there, and awaiting shipment, or the amount held there in anticipation of its use for the purchase of silver; that, save to the extent of 20 crores, which might be held in securities of the Government of India, the balance should be held in securities of the United Kingdom of no longer maturity than 12 months; that of 20 crores of rupee securities, 12 crores might be securities created by the Government for issue to the reserve; and that currency notes up to an amount not exceeding Rs. 5 crores might be issued against bills of exchange of a maturity of not

more than 90 days. The temporary arrangements until the permanent measures could be introduced were that the permissive maximum limit of Rs. 120 crores for the fiduciary portion of the reserve consisting of both Indian and English securities was reduced to Rs. 85 crores, and that in order to hasten the establishment of the permanent constitution, the Government bound itself to pay into the Reserve all interest derived from the securities in the Reserve as well as that accruing from the Gold Standard Reserve, after it reached the sum of £ 40 million, of which it was then only £ 2¾ million short.

The provisions that the gold and silver in the Paper Currency Reserve should be held in India, with the exception of £ 5 million, which may be held in England, and that in order to secure some elasticity in the note issue, notes to the extent of Rs. 5 crores may be issued on the security of export bills of exchange, deserve full support, but the adoption of the Committee's other recommendations, that the principle upon which the note issue had all along been based, namely that the invested portion of the reserve must not exceed a fixed maximum, should be abandoned in favour of the regulation that the metallic portion of the reserve must not fall below a minimum per centage of the total issue, that only 40 per cent (50 per cent in the Government's opinion) of the gross circulation should be regarded as the suitable minimum, and that for some time the minimum may continue to be even lower, may prove

dangerous. It has been mentioned above that the Committee appears to have adopted a faulty attitude towards the question of the note issue, unsuitable to present Indian conditions, and this belief is strengthened by these recommendations. It has been already mentioned that Western standards are not yet fully appplicable to India in currency matters, and this is especially the case in respect of the problem of note circulation. Even before the war, when the position of the metallic portion of the reserve was exceptionally strong, the confidence of the people in the note issue was not quite strong. Since the war, the weekly statements issued by the Currency Department having been watched with attention and the gradual weakening of the metallic proportion of the reserve aroused a considerable distrust in the note circulation. Indian economists and commercial leaders seem solidly to favour the maintenance of the largest possible metallic backing for the notes, and infinitely to prefer it to any profits that may accrue from investments. Moreover, in the past these profits have been wiped out by the periodical writing down of the capital value of the investments. Further, even if any economies would be secured by large investments of the reserve, they would be dearly purchased by the weakening of confidence, which they would produce. Again, if the investments are not realisable when required, the reserve ceases to perform the functions for which it is built up. This is what actually occurred during the war. It therefore

seems desirable that the invested portion of the reserve should be limited to Rs. 30 crores to be held in the Government of India securities, that the whole of the balance except £ 5 million mentioned above, should be held in gold and silver in India, and that the notes should be made convertible either into gold or rupees at the option of the Government.

The same considerations, *mutatis mutandis* apply to the Gold Standard Reserve, whose *raison d'etre* is the support of exchange. The supporters of the gold-exchange standard including the Chamberlain Commission gave their entire thought to the disturbance of exchange resulting from India's balance of trade becoming unfavourable, owing to bad seasons and crises in India, and therefore, they always favoured the location of the whole of the Gold Standard Reserve in London. They never directed their attention to the possibilities of a disturbance of exchange resulting from an abnormal increase in India's favourable balance of trade due to a war or crisis in England, and to the necessity of keeping the reserve in India. These latter conditions were actually brought about by the war, and India's currency and exchange difficulties would have been substantially less if the reserve had been kept in gold in India. Then, the gold could have been made available to the public against temporary investments in England, and this would have largely obviated the inflation of the note issue, the scramble for

silver which raised its price, and the rise in exchange, that took place as a result of the war. But the reserve was held entirely in England in securities, which proved unrealisable. It is therefore surprising to find that, in spite of this lesson of the war, the Smith Committee considered London to be the proper place for the location of the reserve, on the ground that the object for which it existed was to afford protection against a fall in exchange by meeting demands for sterling remittances to London, and that it recommended that not more than half of the gold in the reserve might ultimately be held in India and made available to the public for foreign remittance either by export or by transfer to the Paper Currency Reserve in India against a corresponding release from the reserve in London, only as a concession to Indian sentiment. Moreover, the Committee thought that, although the Gold Standard Reserve should contain a considerable proportion of gold, it would not be possible for some time to obtain gold beyond meeting the needs of the Paper Currency Reserve and hence it recommended that the Gold Standard Reserve should be held in securities with early dates of maturity. But, if India possesses sterling securities in that reserve, and if she is entitled to mobilise them into gold, it is difficult to understand why she should not be allowed to do so, in addition to meeting the needs of the other reserve. It seems most desirable that as soon as possible the whole of the reserve should be held in gold in India. Then the

gold can be immediately made available to the public for foreign remittance purposes, whenever the balance of trade becomes unfavourable, and it can also be used for meeting difficulties such as those which arose during the war from an abnormal increase in the favourable balance. Another advantage of keeping the reserve in gold in India would be that it would be a source of great strength to the Government of India, which has heavy financial responsibilities in the shape of postal savings bank deposits, Treasury bills and short-term loans, in a country which is liable to financial panics, and in which the banking credit is small in relation to the magnitude of the Government responsibilities and the size of the country. The recommendation of the Committee that the profits from the coinage of silver should continue to be credited to the Gold Standard Reserve, may be accepted, not only for the reason given by it, namely that if the normal current of Indian trade was adversely affected by a rapid fall in prices, a heavier call might be made on the reserve for supporting exchange than had been made in the past, but also for the reason that, if the reserve is to be used in the future for meeting difficulties due to a large increase in the favourable balance of trade, the war has shown that very heavy calls are likely to be made upon it.

One of the lessons of the war has been the failure of the gold-exchange standard, whose basis is the economy of gold secured by concentrating it in central reserves,

and making it available for foreign remittance purposes, the internal circulation consisting of rupees and notes convertible into gold for remittance, at a fixed rate. Till the end of 1920, this standard was proof against the difficulties resulting from an unfavourable turn in the trade balance, but was not so at all against those arising from an abnormal increase in that balance, with the result that, as mentioned above, the Government could not obtain enough silver for its disbursements, that it practically forced notes upon the people, and so depreciated them, and that the reserves invested in securities could not be mobilised into gold, which would have proved most useful in meeting the difficulties of the Government.* Even the Smith Committee, although making a show of maintaining the standard intact, had to abandon it in two fundamental respects and to conform to the gold standard. Firstly, it abandoned the essential principle of the economy of gold by recommending free coinage and circulation of gold. Secondly, the principle adopted by the Committee that Council drafts were not sold for the convenience of trade, although sound, as explained before, knocked the bottom out of the gold-exchange standard, namely the cancellation of trade indebtedness, with the greatest economy of gold, through the provision of cheap facilities for remittance to and from India. The only

* Moreover in the early part of 1921 the standard ceased to be proof even against the difficulties caused by an unfavourable balance of trade, and exchange fell below 1s. 4d. (sterling).

solution of India's currency and exchange difficulties seems to lie in the adoption of a gold standard and a gold currency. It is true that economy of gold is an object to be aimed at, and that gold in circulation is less useful for remittance purposes than gold in central reserves, provided that the reserves are kept available at all times. But it may be pointed out that this internal economy of gold was attained in the United Kingdom before the war, when its currency system was healthy, by a remarkable development of the deposit-cheque system, and was immensely helped by the growth of the method of cancelling or avoiding gold imports in the settlement of favourable foreign exchanges, by means of foreign investments. For any substantial development of these methods, the people of India, a subject people with a history of centuries of insecurity of private property, are totally unprepared at present, and any attempts to force upon them an internal economy of gold before they are educated up to it, are bound to aggravate India's currency ills instead of curing them. The aim can be achieved only gradually by a steady development of the banking habit in the people and by creating confidence in the note issue, and in the meanwhile a free circulation of gold will go a long way in ensuring health and stability to India's currency and exchange system.

Finally, it seems essential to emphasise the necessity of abandoning as far as possible the official management of the Indian currency and exchange system at almost

every stage and in every detail, and of leaving it to its own free, open, and automatic action, in conformity with natural economic principles. The play of economic forces is diverse and intricate, and any official interpretation of it in any country is likely to be often incorrect. Moreover, wherever official management is necessary, it should be in the hands of the Government of India, and should not be left to the decision of the Secretary of State.* The latter operates from a distance of six thousand miles from the Indian financial centres, remote from all Indian economic thought and influence, and in direct touch with and under the influence of the London money market. Moreover, it is often impossible to obtain any information in India of the reasons which guide his actions. The Government of India, on the other hand, is in close contact with Indian views, and its Finance Ministers have for some years past kept themselves in personal touch with financial and commercial opinion, although that opinion has not been given its due weight, mainly because all important decisions have been in the hands of the Secretary of State. It seems therefore essential that in future all decisions on India's currency and exchange policy should be left to the Government of India to be taken by it, with the advice of the Indian financial and commercial community, and with the sanction of the reformed and enlarged Legislative Assembly.

* Cf. Sir Stanley Reed's memorandum to the Smith Committee.

Liabilities and Assets of Presidency, Exchange and Joint Stock Banks * In £ million.

PRESIDENCY BANKS.

	LIABILITIES.					ASSETS.				
	Capital	Reserves	Deposits	Other items	Total	Cash Balances	Invest-ments	Bills dis-counted & purchased, loans etc.	Other items	Total
31st. Dec. 1913	2.5	2.5	28.2	.5	33.7	10.7	4.4	18.3	.3	33.7
,, 1914	2.5	2.6	30.5	.4	36.0	14.4	6.4	14.9	.4	36.0
,, 1915	2.5	2.5	29.0	.6	34.6	10.0	8.4	15.5	.5	34.6
,, 1916	2.5	2.4	33.3	.5	38.7	12.3	8.3	17.5	.5	38.7
,, 1917	2.5	2.4	50.3	.4	55.6	23.4	10.7	21.1	.5	55.6
,, 1918	2.5	2.3	39.7	.6	45.1	12.1	8.5	24.0	.5	45.1

	PERCENTAGES OF LIABILITIES.				PERCENTAGES OF ASSETS.				
	Capital and reserve	Deposits etc.	Other Items	Total	Cash Balances	Invest-ments	Bills discounted & purchased, loans etc.	Other items	Total
31st. Decem. 1913..	14.7	83.7	1.6		31.6	13.2	54.2	1.0	
,, 1914..	14.3	84.3	1.4		39.9	17.7	41.3	1.1	
,, 1915..	14.4	84.0	1.6		29.4	24.2	45.0	1.4	
,, 1916..	12.6	86.1	1.3		31.8	21.4	45.4	1.4	
,, 1917..	8.8	90.4	0.8		42.0	19.3	37.9	0.8	

* Compiled from the Statistical Tables relating to Banks in India.

Table 39.

JOINT-STOCK BANKS.

31st. Dec.	LIABILITIES. No. of Banks	Capital & Reserves	Deposits etc.	Sundry Liabilities	Profits	Total	ASSETS. Cash in hand, at Bankers etc.	Invest ments etc.	Bills discounted etc.	Bank premises sundries	Total
1913	14	1.8	12.9	.3	.1	15.0	2.5	2.1	10.1	.3	15.0
1914	14	2.0	11.3	.4	.1	13.8	2.0	1.8	9.4	.6	13.8
1915	14	2.1	11.6	.3	.1	14.1	2.6	2.2	8.9	.4	14.1
1916	13*	2.0	14.2	.3	.2	16.6	3.5	2.6	10.1	.4	16.6
1917	12†	2.5	19.3	.4	.2	22.3	4.8	3.2	13.5	.8	22.3
1918	13	3.7	26.6	**	**	..	6.2	**	**	**	..
	Percentages of Liabilities.						**Percentages of Assets**				
1913	14	11.8	85.5	2.2	0.5		16.6	14.1	67.2	2.1	
1914	14	14.8	82.0	2.7	0.5		14.5	13.3	67.8	4.4	
1915	14	14.8	82.8	1.9	0.5		18.3	16.0	63.0	2.7	
1916	13*	12.0	85.0	2.1	0.9		21.1	15.8	60.5	2.7	
1917	12†	11.1	86.3	1.9	0.7		21.3	14.6	60.5	3.6	

*One of the banks (the Punjab Banking Co.) was amalgamated with the Alliance Bank of Simla in 1916.

†One of the banks (the Standard Bank) went into liquidation in 1917.

** Figures regarding these items not available.

Table 40.

EXCHANGE BANKS.

		LIABILITIES							ASSETS					
31st Dec.	No. of Banks	Capital & Reserves.	Notes in Circulation outside India.	Acceptances Loans &c.	Miscel. credits.	Deposits & Current Accounts.	Profits.	Total.	Cash in hand, at bankers &c.	Investments &c.	Bills of exchange &c.	Bills discounted etc.	Buildings, & Sundries	Total.
1913 ..	9	27.2	3.9	45.8	1.7	151.9	2.4	233.0	27.3	13.1	92.5	72.9	27.3	233.0
1914 ..	9	27.9	4.4	39.2	1.1	140.7	2.3	215.5	44.9	15.5	63.4	69.5	22.2	215.5
1915 ..	9	27.9	4.4	27.3	0.7	151.9	2.3	214.2	42.4	18.4	75.5	65.9	12.0	214.2
1916 ..	9	28.3	5.7	47.1	1.1	180.7	2.7	265.7	46.0	16.6	107.5	80.8	14.7	265.7
1917 ..	9	29.9	5.8	55.0	4.2	251.7	3.3	350.0	75.8	17.7	164.0	80.4	12.0	350.0
1918 *	9	31.2	×	×	×	305.6	×	..	71.2	31.0	×	142.3	×	..
Exchange bank doing a considerable portion of their business in India.														
1913 ..	5	6.9	0.9	10.6	0.	43.4	0.7	63.2	10.6	4.3	16.5	26.7	5.0	63.2
1914 ..	5	7.3	1.0	6.5	0	45.9	0.8	62.9	14.5	6.9	15.7	21.6	4.2	62.9
1915 ..	5	7.5	1.1	7.8	..	57.1	0.8	74.2	15.9	10.4	20.6	23.5	3.8	74.2
1916 ..	5	7.5	1.1	11.1	..	67.3	0.9	88.0	19.7	9.0	27.0	28.2	4.0	88.0
1917 ..	5	7.8	1.0	7.5	1.3	84.5	1.0	103.2	27.9	10.3	33.4	26.7	4.9	103.2
1918 ..	5	9.2	×	×	×	98.7	×	..	27.0	12.8	×	34.3	×	..
Percentages of Liabilities									**Percentages of Assets.**					
1913 ..	9	11.7	1.7	19.7	.7	65.2	1.0		11.7	5.6	39.7	31.3	11.7	..
1914 ..	9	13.0	2.0	18.2	.5	65.3	1.0		20.9	7.2	29.4	32.2	10.3	..
1915 ..	9	13.0	2.0	12.7	.3	70.9	1.1		19.8	8.6	35.2	30.8	5.6	..
1916 ..	9	10.7	2.2	17.7	.4	68.0	1.0		17.3	6.2	40.5	30.4	5.6	..
1917 ..	9	8.5	1.7	15.7	1.2	71.9	1.0		21.7	5.1	46.8	23.0	3.4	..
Exchange Banks doing a considerable portion of their business in India.														
1913 ..	5	10.9	1.4	16.9	1.0	68.7	1.1		16.8	6.9	26.2	42.2	7.9	..
1914 ..	5	11.7	1.6	11.9	1.5	73.3	1.3		23.3	10.9	24.8	34.4	6.6	..
1915 ..	5	10.0	1.5	10.4	..	77.0	1.1		21.3	14.0	27.8	31.8	5.1	..
1916 ..	5	8.5	1.2	12.7	..	76.5	1.1		22.4	10.2	30.7	32.1	4.6	..
1917 ..	5	7.5	1.0	7.3	1.3	81.9	1.1		27.0	10.0	32.3	25.9	4.8	..

* Excludes the Bank of Taiwan which opened a branch in India.
× Figures regarding these items not available.

Table 41.

CHAPTER X.

The Banking System.

At the time of the outbreak of the war, the Indian banking system as a whole was very weak on account of the banking crisis of 1913 and the subsequent failures. The position of the Presidency and Exchange banks was quite sound and sufficiently strong. The former enjoyed the prestige derived from acting as bankers to the Government and were strictly restricted in their business by law; the latter were backed by very powerful financial interests abroad and most of them had existed for many years. The weakness of the system was due to the unsatisfactory condition of the Indian Joint-Stock banking, resulting in numerous failures, which commenced in 1913 and continued till 1917. The extent of the catastrophe may be realised from the fact that during these years no less than 87 banks had to be liquidated, and that no less than 34 per cent of the total paid-up capital of Indian Joint-Stock banks was lost in this way. It seems necessary to examine briefly the causes of these failures in order to find out how far the war enabled the system to remove the defects, which had thus been brought to light. During the decade preceding the war a large number of mushroom banks grew up in Western India, the Punjab and the United Provinces, and having developed in smooth times and not

having existed long enough to remember any previous crisis, they conducted their business in violation even of the elementary priciples of banking.* In the first place, they had an imposing authorised capital, but the subscribed capital was far smaller, and the paid-up capital was still smaller. The aggregate subscribed and paid-up capitals were only 40 and 14 per cent. respectively of the authorised capital. This deficiency of capital made them almost wholly dependent upon deposits for conducting their business, and in order to attract them they offered much higher rates of interest than they could really afford, if they had conducted legitimate business only. Therefore, in order to be able to pay the high rates, they employed the funds at their disposal in the most hazardous enterprises. Large sums were locked up in speculative dealings in silver, pearls and other commodities, long-term businesses were financed without efficient investigations into their soundness on the chance of earning large profits, and short-term deposits were used for this purpose, and too large a proportion of the total available funds was frequently sunk in a single business. Many of the directors and managers had little knowledge either of the principles or of the practice of banking, and some of them resorted even to dishonesty, fraud, and criminal mismanagement. Thus, they lent the funds of the banks of which they were the directors or managers to themselves or to concerns in

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* Compare Keynes, Indian Currency & Finance, pp. 223-25, and Shirras, Indian Finace & Banking, pp. 365-7.

which they were directors or partners; they made away with the assets of the banks by showing in the books, debts due to the banks that did not exist; to hide all this mismanagement and fraud the books were left in an incomplete state, not being written up to date, or they were falsely made up; window-dressing was freely resorted to in making up the balance-sheets; and in a few cases dividends were paid out of capital. After knowing this, it will not surprise any one to know that very low cash reserves were kept, amounting in the aggregate to no more than 10 per cent. of the liabilities. These were hopelessly inadequate to serve their purpose in a country like India, where the banking habit is still far from being formed.

It must not, however, be supposed that the above description of the causes of the banking crisis and failures was applicable to all the Indian Joint-Stock banks. Many of them, especially the larger and the older ones, conducted their work on sound lines, and, although not so strong as the Presidency or Exchange banks, were strong enough to withstand the crisis without untoward consequences. The description applies chiefly to the small banks which rapidly sprang up after 1904. Again no conclusion regarding the capacity of Indians to manage joint-stock banks can be drawn from the bank failures, because a common feature in the early history of joint-stock banking in every country including the United Kingdom has been a large

number of bank failures. Dr. Andreades points out that from 1820 to 1870 the Bank of England came to the verge of bankruptcy every 10 years,* while the lists of banks that failed in the United Kingdom and the U. S. A. are of enormous length. Failures are inevitable during the infancy of joint-stock banking in any country, and India has not yet passed through that stage. Nevertheless, it is quite true that the method pursued by many of the Indian Joint-Stock banks were such as to invite the most serious crisis, and that, when it actually came, they were altogether unable to resist it. The crisis was aggravated by the complete absence of co-operation between the Indian Joint-Stock Banks themselves, or between them and the Presidency and Exchange Banks. This was the result of the complete decentralisation of the Indian banking system, *i. e.* of the absence of a national bank, which in a Western country guides the general banking policy of the country, and endeavours to mitigate a crisis by remedial action†

Having thus examined briefly the position of the Indian banking system just before the war, we may proceed to consider the developments that arose after the outbreak of the war. The best method would be to combine the balance-sheets of individual banks into three.

*** Andreades, History of the Bank of England, p. 404.**

† Compare Malaviya's note to the Report of the Indian Industrial Commission, pp. 337-8.

the first for the Presidency banks, the second for the Exchange banks and the third for the thirteen major Indian joint-stock banks, and to examine the various items on the sides of liabilities and assets. In doing so it should be borne in mind that the conditions of the country from the banking point of view are yet very different from those in the West. The population is vast, scattered, and largely illiterate; the means of communication in many parts are defective ; the country is in a state of industrial transition ; it has passed through numerous currency difficulties ; the joint-stock banking has grown recently and has not yet passed through the initial stages ; it has been allowed to grow without any central control or definite policy ; every nine out of ten men keep their savings with themselves , or are under the sway of the usurious money-lender, and the tenth has only irregular dealings with his bank, has little confidence in its solvency and makes a run upon it at the first sign of any trouble. Thus, it becomes clear that Western standards are not yet fully applicable to the Indian banking system. For instance, a proportion of cash reserve to liabilities, that may be considered adequate in a Western country, would be far from being so in India. Hence any judgment upon the strength of the Indian banking system would lose much of its value, if the difference between Indian and Western conditions is not adiquately taken into account.

One of the striking features of the system was the small amount of capital and the relatively large amount of

business handled with it. Although this enabled the banks to pay good dividends with a narrow margin of profit on their turnover, it was an element of weakness and was fraught with dangers under the prevailing conditions of the country. An examination of the three combined balance-sheets given at the beginning of this chapter shows that the position of the banking system from this point of view further weakned during the war. While the amount of the business handled by it increased to a large extent, the increase in bank capital and reserves was small. The capital of the Presidency and Joint-Stock banks remained the same as before the war, but the reserves of the former slightly diminished, while those of the latter slightly increased. The capital and reserves of the Exchange banks increased appreciably, but they have numerous branches out of India, and the whole of their capital and reserves cannot be said to belong to the Indian system. However, it is not possible to find out the share of their capital and reserves that may be assigned to their branches in India.

The most striking feature of the Indian banking system during the war was the great increase in deposits. At the end of 1917 as compared with the end of 1913, the deposits of the Presidency banks increased by 78 per cent, those of Joint-Stock banks by 49 per cent, those of the Exchange banks in India by 83 per cent, and the total deposits of the Indian banking system by 65 per cent. At the end of 1918, the deposits of the Presidency banks

declined appreciably, but the total deposits of all the banks increased further to a substantial extent. This increase led the unwary to conclude that India enjoyed an unprecedented prosperity during the war. But, in reality most of the increase was merely an evidence of indebtedness and inflation and not of prosperity, because most of the increase in the deposits consisted not of cash paid in, but of credits borrowed. This creation of credit further increased the means of payment in the country, which were already increased by the expansion of the paper currency, and led to a further rise in prices. The creation of this large mass of credit was mainly the result of Government war finance. The Government of India financed its own war expenditure in India as well as that on behalf of the Home Government, by means of raising loans and obtaining credits in the form of Indian Treasury bills. The banks had to purchase large amounts of war loans and Treasury bills themselves, as well as to grant large amounts of credit to their customers to enable them to make similar purchases. These purchases of loans and bills were paid for by means of the grant or transfer of credit to the Government which transferred it to the public by means of payments to contractors, manufacturing firms etc. The result was that the deposits of the banks were increased by the amount of their subscriptions to the Government loans and bills, and by the amount of the credit granted by them to their customers to enable them to make similar purchases. It is true that

a part of the increase of deposits consisted of cash paid in, and would have taken place in normal conditions. But that was a comparatively small part, and a very large part of the increase arose out of the inflation of credit, and was an evidence of indebtedness only. Moreover, a comparison of the increase of deposits in India with that in the other principal countries leads on the whole to unfavourable results.

Bank deposits in principal countries in £ million.

	End of 1913	End of 1917	Percentage of increase
Germany	543	1,472	171
Japan	185	416	125
U. S. A.	2,101	4,081	94
United Kingdom	1,104	1,872	70
India	65	107	65
France	266	435	64
Australia	150	209	39
Canada	233	320	37

Table 42.

It is evident that the case of Germany was thoroughly bad, and that inflation of credit had proceeded there to a far higher stage than in India. It is true that the proportion of the increase of deposits in Japan and the U.S.A. was substantially higher than in India, but taking into account the enormous increase in their foreign trade, and the failure of India's foreign trade even to recover completely from the adverse effects of the war, which was considered in an earlier chapter, it is only fair to conclude that a larger proportion of the increase of deposits in these two countries than in India was an evidence of wealth and not of indebtedness, although it is not possible to find out the exact proportions, and that, eliminating the increase of deposits resulting from a real

increase of wealth, it cannot be said that inflation of credit proceeded further in the two countries than in India. Then it is surprising to find that, although the United Kingdom and France had to bear far larger burdens of war finance than India, the proportion of the increase of deposits in France was even slightly less than in India, and that the proportion in the United Kingdom was only slightly higher. Canada and Australia fared much better than India in this matter. Thus it appears that till the end of 1917 India did not fare better in respect of the inflation of bank credit than the other countries with the exception of Germany.

The increase in the liabilities in the shape of deposits in Indian banks was, however, accompanied by a large increase in cash balances, and from this point of view the war considerably strengthened the Indian banking system till the end of 1917. The extent of the improvement is shown by the following table :—

Proportion per cent. of cash to liabilities on deposits of the several classes of banks on 31st December each year.

	1913	1914	1915	1916	1917	1918
Presidency Banks	36	46	34	45	45	29
Exchange Banks.						
(1) Banks doing a considerable portion of their business in India..	19	28	19	25	40	20
(2) Banks which are agencies of large banks doing business all over Asia	17	26	41	35	160	116
Indian Joint Stocks Banks.						
(1) Major Banks with capital and reserve of Rs. 5 lakhs and over	18	21	22	24	25	23
(2) Minor Banks, with capital and reserve between Rs. 1 and 5 lakhs	16	22	22	17	21	24

Table 43.

It has been already mentioned that one of the principal causes of the crisis and failures of 1913 was the inadequacy of cash reserves. The crisis taught the banks which survived it a good lesson, the importance of which was made more evident to them by their experiences at the outbreak of the war. Therefore, during the war they endeavoured to strengthen their cash reserves, and they were enabled to do so by the fact that the profits of industries, which in normal times would have been invested in the creation of new enterprises or in the expansion of old enterprises, or remitted to London, could not be utilised in these ways on account of the abnormal war conditions, and so were kept with the banks. The increase in the cash balances of the Exchange banks was specially noticeable, and was due to causes peculiar to themselves. On account of the difficulty of obtaining remittances from their head offices, and also of the delays in cables, their branches in India found it necesssary to maintain proportionately larger balances, and did so by imports of gold. This accretion to their resources was till the end of 1917, an important factor in the increase of the cash balances of the Presidency banks, which are bankers' banks, and with which the Exchange banks keep a portion of their resources on deposit. At the end of 1918, the proportion of cash to liabilities declined considerably, in the case of the Presidency banks, and the Exchange banks doing a large part of their business in India. This, however, was temporary, and calls for no adverse criticism, because their

financial position has been very strong. It is satisfactory to note that the improvement in this respect was on the whole kept up in the case of the Indian Joint-Stock banks, which constitute the most vulnerable part of the Indian banking system.

After the above explanation of the nature of the remarkable increase of deposits, the large increase in the investments of the banks can easily be understood. The investments of the Presidency banks increased by 142 per cent, those of the Exchange banks doing a considerable portion of their business in India by 137 per cent, and those of the Joint-Stock banks by 53 per cent. This increase was mostly due to the large purchases of Government issues of all kinds by the banks from the outbreak of the war, in order to assist the Government in its war finance. These investments produced the same effect on the deposits of the banks as the advances made by them.

With regard to discounts and advances, it will be seen that there was a considerable increase in the case of the Presidency and Joint-Stock banks, and that the increase in the case of the Exchange banks was inappreciable. The latter was largely due to the restrictions imposed by the Government on the discounting of foreign bills, to enable it to cope with the currency and exchange difficulties explained before.

Thus, on the whole, the Indian banking system did well during the war. This is shown by the fact that 11 out of the 15 most powerful banks in India declared higher dividends in spite of the necessity of writing down their investments in Government securities, which continued to depreciate in value. The remarkable increase in deposits was an unfavourable feature, but, from the banking point of view, it was met by strengthening the cash reserves.

Moreover, other important banking developments arose out of the war. The crisis of 1913 clearly showed the defects and dangers of the free banking system of India, under which the country had no definite banking policy, and each bank conducted its business entirely in its own way without any control from a central institution. The lesson taught by the crisis was reinforced by the experiences during the war. Moreover, all the other principal countries of the world, with the exception of the U. S. A., had developed a central system long before the war. Even the U. S. A. realised the grave dangers of a decentralised and uncontrolled system, decided to adopt a central system just before the outbreak of the war, and worked it out during the war.* At the end of the war India alone remained in the possession of an uncontrolled system. The advantages from the existence of a central banking

* Anderson, Effects of the War on Money, Credit and Banking in France and the U. S. A. and Agger, Organised Banking pp. 265 ff.

institution were great and obvious, and it was decided to establish such an institution by an amalgamation of the three Presidency Banks into the Imperial Bank of India. Several objections were raised against the scheme, such as provincial jealousies, banking rivalries, the difficulty of finding a competent directorate in the country, and the capacity of independent banks, familiar with local conditions, to realise local needs more accurately than the branches of a central institution. The difficulties however have been overcome, and the scheme has been put into operation by the Imperial Bank Act of 1920. Such an institution was bound to be established sooner or later, because all the tendencies had been in this direction, but the development was hastened by the war.

Although the war afforded a considerable stimulus to industrial development in India, it also showed how much that development was being hampered by the lack of banking facilities. Progress of branch banking is one of the greatest needs of the country to-day, and the solution of this urgent problem is being materially advanced by the Imperial Bank of India. At present there is almost complete lack of banking facilities outside large-sized towns. The proportion of towns with a population of 10,000 and over, in which the banks and their branches are situated, is only 25 per cent. There are more than 200 districts in which there is no branch of the Presidency banks, and only in a few of these is there a branch of a

joint-stock bank of any importance.* It is then not surprising that the Indian banking system compares very unfavourably with that in other countries from the point of view of branches, capital and deposits.

Number of banks, capital, deposits and foreign trade in the principal countries.

	India 1917	U. K. 1918	U. S. 1917	Canada 1917	Australia 1917	Japan 1916
Number of banks ..	55	54	28,913	21	24	2,143
„ „ branches ..	304	9,303	..	3,306	2,332	3,731
Capital £ million ..	23*	88	482	23	35	67
Deposits £ million† ..	118	2,355	5,767	324	316	494
Deposits per head £ ..	0·7	52	55	46	63	8
Foreign trade £ million	253	1,849	1,886	416	174	188

* Includes the total capital (£ 15 million) of the Exchange banks as their Indian portion cannot be estimated.

† Includes Savings bank deposits.

Table 44.

The indispensable preliminary to the extension of banking was the establishment of a powerful central bank, closely connected with the Government, and pursuing a definite policy of establishing an increasing number of branches throughout the country. If the Presidency banks had continued to work independently, no substantial increase in the number of their branches could have been expected in the near future owing to territorial restrictions and considerations of profit and loss.† The amalgamated institution, however, in return for valuable

* To realise the extreme shortage and the inadequate distribution of banking facilities in India, see the map facing, p. 58 of the Statement exhibiting the Moral and Material Progress of India 1919.

† Despatch of the Government of India to the Secretary of State on the Amalgamation of the Presidency Banks, June 1919.

privileges granted by the Government, has undertaken to establish 100 new branches within five years out of which the location of 25 will be determined by the Government, and the aim is to continue this progressive policy, until every town of importance possesses a branch of the Imperial bank. It is true that this extension of banking facilities will not immediately attract the deposits of the public now lying idle in hoards, and turn them to productive uses. The process is bound to take time, because the banking habit cannot be easily created in a community, the general level of whose education is very low. But a good beginning has already been made, because the mere establishment of a branch of the Imperial bank in a district, conducting Government treasury and public debt business, possessing undoubted stability, and making advances to local traders on reasonable terms, will exercise a considerable influence upon the mental attitude of the public towards banking in general, and in course of time these branches may fairly be expected to secure a large amount of deposits from them, thus effecting a considerable economy in the use of the precious metals, and avoiding the existing waste of the resources of the country.

The Imperial bank will extend the banking facilities in the country not merely by establishing a large number of branches, but also by affording a valuable stimulus to the development of joint-stock banking. It was futile to expect any large increase in the number of joint-stock

banks in the up-country districts or in their financial stability, so long as they had not at their door the branches of a powerful central institution, to which they could look for guidance at all times in their general financial policy, and for assistance in times of difficulties or of tight money, when they desired to raise loans by pledging their gilt-edged securities, and in quelling an incipient panic. It is true that in the past the branches of the Presidency banks acted as bankers' banks, and rendered assistance of this kind as far as they could. But the guidance and help given to the joint-stock banks were altogether insufficient owing to the small number of the branches of the Presidency banks. In the near future the joint-stock banks will have behind them the Imperial bank with its numerous branches, upon which they will be able to rely for guidance and assistance, which will exercise an effective control over their discounts and advances and the creation of deposits, thus minimising the possibilities of a crisis and mitigating its severities if it takes place, and which will form the solid background necessary for the healthy development of various forms of joint-stock banking, agricultural, industrial and ordinary, of which the country is in great need. For such a development, moreover, an equally vital necessity is a large supply of efficient men, properly trained in the modern methods of banking. The establishment of a large number of branches of the Imperial bank will involve the employment and training of a large number of Indians, and the demand for and the training of these

men by the Imperial bank will immensely stimulate their supply for the joint- stock banks.

The internal trade of the country also will benefit substantially from the creation of the Imperial bank and the multiplication of its branches. In the past, the Presidency banks and their branches gave valuable assistance to indigenous bankers in their work of financing the internal trade, by purchasing and rediscounting their internal bills of exchange called hundis. By the rates which they charged on the rediscount of hundis, and by their readiness or refusal to extend these commitments, they determined the provision of credit and the rates charged for it in the country money markets. It is therefore clear that the Imperial bank, by the extension of its operations through a largely increased number of branches, and by employing more funds in the rediscount of hundis, will assist the finance of the internal trade to a much larger extent than the Presidency banks could do.

Intimate relations between the Imperial bank and the Government of India will be established, the aim is to develop them further in the course of time, and there is no doubt that both will benefit from them. A substantial part of the financial and banking work hitherto performed by the Government of India will be transferred to the Imperial bank, which will relieve the officers of the Government of the financial responsibilities, for which they

do not adequately possess either the training or the experience, and whose work will be less open to constant public criticism than that of the Government officers. In the first place, with the co-operation of the Imperial bank, the administration of the public debt will be improved by a considerable measures of decentralisation, and a good deal of the work connected with small holdings of securities, which at present is performed only at Calcutta, will be conducted in the districts in which the securities are held. The policy of decentralisation is to be further developed, and in the course of time, as the Imperial bank establishes branches in every district, it will become possible for the majority of up-country holders of the Government securities to get all the business connected with them done at their district headquarters. This will avoid the irritating delay and the perplexingly elaborate procedure involved in the centralisation of the public debt business at Calcutta, and will encourage investments in Government securities in the up-country districts.

Secondly, the Reserve Treasuries will be abolished, and the Government balances kept in them will be transferred to the Imperial bank. It has been explained in an earlier chapter that during the war the Government was compelled by its measures of war finance to keep a large portion of their balances with the Presidency banks. As this policy proved beneficial to the interests of the Government, the banks, and the money market in general, it will

be made permanent, and eventually, when the branches of the Imperial bank are established at all the district headquarters, the whole of the Government balances in India will be kept with the Imperial Bank, and the independent treasury system will completely disappear. The control of large Government balances, without having to pay interest for their use, will immensely strengthen the position of the Imperial Bank, especially during the busy season. But, the Government will have to undertake a great responsibility in keeping a large part of their balances with the Imperial bank, and is therefore bound to take special measures for their protection and security, and in order to ensure that the Imperial bank should not depend upon them unduly for its cash reserve, and that they should be immediately available whenever required. The abolition of the Reserve Treasuries will deprive the Government of its present power of withdrawing at any time its deposits from the Presidency banks in excess of the guaranteed minimum, which enables it to influence the general policy of the banks. The Act of 1920 therefore provides for a Government representative, who will be the Controller of currency, on the governing body of the Imperial bank, who will keep the Government in touch with all the important developments in the general policy of the bank, and who will be empowered to hold up any important action of the bank as affecting the Government interests or the safety of its balances, pending the orders of the Government thereon. He will, however, be armed with this powe

only as a safeguard, and the necessity for its use is not likely to arise at any time.

The establishment of a branch of the Imperial bank in London will also prove advantageous both to the bank and the Government. Through it the bank will secure a direct access to the London money market, will buy and sell bullion for consumption in the Indian bazzaars under the control of the Secretary of State, will rediscount the bills of the Exchange banks, and will be placed on the same footing as the approved borrowers, with regard to the loans at short notice of the cash balances of the Secretary of State. In addition, it is likely that the expert advice of the London branch of the bank will be taken in lending out the cash balances of the Secretary of State. His remittance business will not be conducted by it in the near future, but the use by the bank of its own resources in the business of rediscounting bills of exchange will probably, in the course of time, show the desirability of employing it for the transfer of public funds from India to London and *vice versa.*

The Imperial bank will moreover benefit substantially from the removal of some of the restrictions upon working imposed by the Presidency Bank Act of 1876. It is true that the present strength of the Presidency banks is largely due to the wholesome checks imposed by that act. But it was framed forty years ago, when the banks were

far less strong than at the end of the war, and imposed restrictions, which were beneficial and necessary then, but which had become needless in the course of time, and merely hindered the further development of the banks. However, one unnecessary restriction remains, and it is that the Imperial bank will not be allowed to conduct any exchange business directly by discounting foreign bills of exchange. The continuance of the restriction has been defended on two grounds, firstly that the exchange business involves considerable risks, and secondly that, if the Imperial bank were to compete with the Exchange banks in this business, it would lose the use of the balances maintained by them with it. However, it may be pointed out, firstly that up to now no Exchange bank has failed, and that all of them have earned large profits especially in recent years, and secondly that the Exchange banks will not be able to dispense with the services of the Imperial bank, which will be the bankers' bank. In the past the Exchange banks have looked to the Presidency banks for guidance and assistance in times of trouble, and they cannot expect to obtain the same from the Imperial bank, unless they keep substantial balances with it. It is probable that the maintenance of this restriction upon the working of the Imperial bank will merely serve to preserve the monopoly of this business for the Exchange banks.

In addition to the above advantages, which will be mutually secured by the Government and the Imperial

bank from the creation of intimate relations between them, others are likely to arise in the course of time. The manage ment of the paper currency is an instance of this kind. It will not be possible to transfer this management to the Imperial bank in the immediate future, as the position of the paper currency is unsatisfactory and uncertain on account of its inflation during the war. When, however, a stable policy is evolved and currency conditions settle down, and when the management of the paper currency becomes a more or less routine application of firmly established and sound principles, it will be desirable to hand over the management to the Imperial bank.

The affairs of the Presidency banks will be managed by their respective local boards of directors as before, but the general policy of the central institution will be directed by a central board consisting of the presidents, vice-presidents and secretaries of the local boards, who will represent the interests of the shareholders, of four non-officials nominated by the Government to watch over the interests of the general taxpayer, and of a controller of currency representing the Government directly. Two members selected by the central board from among themselves will form their executive. The constitution of the central board thus corresponds to that of the Federal Reserve Board in the U. S. A.

Finally, the organisation of industrial banks was considerably stimulated by the war. The immense difficulties

o the middle class industrialists in respect of their capital requirements were explained in an earlier chapter; but no industrial bank existed before the war to give them assistance, largely because the large profits, which were secured from the ordinary commercial banking, led the banking community to neglect industrial banking. Moreover, none of the banks in existence before the war possessed the special organisation necessary to enable them to finance industrial projects. The business of the Presidency banks was restricted by law, and, in addition, they could not lock up their deposits in industrial ventures for any length of time. The Exchange banks were too busy with the finance of the foreign trade to pay any attention to industrial finance, and had no resources to spare during the busy season. Moreover, the fact that their directorate and head-offices were outside India, was an obstacle in the way of their taking up industrial banking. Some of the Indian Joint-Stock banks endeavoured to finance industrial undertakings, but came to grief in 1913 and in the two subsequent years, because they possessed insufficient capital and depended mainly upon short-term deposits. They were organised for commercial banking, and did not possess enough capital, long-term deposits and technical knowledge to undertake industrial finance with success. However, the stimulus afforded to the industrial development by the war showed not merely the urgency of the development of industrial banking, but also the great future which lay open before it. Secondly, large amounts of capital

seeking profitable investments became available in the capital cities on account of the large profits secured by some merchants during the war, and therefore sound projects for the organisation of industrial banks were likely to receive an adequate response from the investing public. Thirdly, the difficulties of banks in respect of the technical assistance necessary to enable them to know the conditions and prospects of industrial ventures requiring financial help, had diminished on account of the greater guidance afforded by the technical departments of the Government and the promise of more assistance in the near future through the organisation of new technical services. Lastly, the new spirit of enterprise created by the war turned into the channel of industrial banking, among many others. The result of the operation of these factors has been that four industrial banks, with large capitals, *viz.* the Gwalior Financial Corporation, and the Tata, Karnani and Calcutta Industrial banks are now in existence, and are likely to be followed by others in the near future. The special business of these banks is to finance industrial projects and the development of existing concerns by making advances to them or by underwriting their bonds, but they conduct the ordinary commercial banking business also. The combination of the two functions is not very desirable, because it involves the danger of locking up short-term deposits. But, it is necessary, because the restriction of the business of the banks to industrial finance will not enable them for some years to pay good dividends on their

large capitals. The danger, however, may be obviated by using share and debenture capital and long-term deposits only for the purposes of industrial finance, and it may be desirable to prohibit by law the use of short-term deposits for this purpose.*

The war thus brought about, at any rate hastened, highly important developments in the Indian banking system. However, much remains to be done to remove by means of legislative enactment and inspection, the defects in the system brought to light by the crisis of 1913. Banking legislation in India is unfortunately limited to the Presidency banks, the Joint-Stock banks are subject only to the Indian Companies' Act, and there exists no special banking legislation to control their operations. They would have greatly benefitted in the past, if their business had been subjected to restrictions similar to those in the Presidency Banks' Act of 1876 and in the banking legislation of other countries. Their future development will depend a great deal upon the existence or absence of such restrictions.† In the light of the experiences of 1913 it seems desirable that no institution should be allowed to call itself a bank unless it restricts its operations to proper banking functions only. This would prevent the recurrence of the practice of some institutions prior to 1913, which conducted all sorts of miscellaneous operations, and

* See Shirras, Indian Finance and Banking, p. 394.

† Compare Shirras, Indian Finance and Banking, pp. 419-20.

called themselves banks in order to hoodwink the public and to attract their savings. Secondly, no bank should be allowed to commence its business, until it secures a certain paid-up capital. Legislation of this kind has proved very advantageous in Canada, and in India it would obviate the difficulties that arose in 1913, because some banks attracted considerable deposits from the ignorant public by publishing their authorised capital, which was large, and avoiding any mention of their paid-up capital, which was too small for the conduct of banking operations. Thirdly, it seems desirable to restrict by law the grant of loans and the discounting of paper, for, one of the causes of the failures of 1913 was the grant of excessive loans to, or the discounting of too much paper of, a single person. Fourthly, the regulation of the cash balances also seems to be necessary. The tendency for some banks has been to invest too large an amount of their assets in real estate and even in unsound securities. In 1913 these assets could not be realised quickly or without an immense loss. The position has substantially improved since that time, but it is not free from danger. The regulation of cash balances in relation to liabilities is an important feature of the Federal Reserve Act of the U. S. A., and it would prove a valuable guide in framing similar legislation for India. Lastly, the best preventive for most banking maladies is public inspection, which is another important feature of the Federal Reserve Act. The Presidency banks publish a weekly statement; most of the other

banks publish an annual statement, but no monthly or quarterly statement. It would be advantageous if the banks were made by law to publish a monthly balance-sheet, which would give a clear idea of their position. Publicity would promote the interests of the banks themselves, because it not merely checks unsound banking but also secures the confidence of the public.

CONCLUSION.

The task of analysing and examining the effects of the war on India's economic life is now at an end, and it remains only to gather up the several threads and to sum up the results.

The preceding pages make it evident that, on the whole, the economic transformation that was proceeding in India before the war, was appreciably hastened by it, and that, so far as economic conditions are concerned, India to-day differs more from India, of which Mr. Ranade wrote, than India immediately before the war did. He wrote that the average Indian was to a large extent the very antipodes of the Economic man on account of the predominant influence of the caste system and the family. But the conception of the economic science has been largely modified since the time when this was written. Even before the war it was generally recognised that the individual was not the best judge of his own interests in all cases, and that state interference was not necessarily an evil. The state interfered frequently on behalf of the individual, with the general approval of the exponents of the science. The economic man, who cared for nothing else than wealth, and who always knew his best interests, was disappearing from the text-books of the science. The crucial experiences of the war have done much to further this process, and economists to-day deal more than ever before with

the man as he is and not with an abstract economic man. Economics is now a study of mankind in the ordinary business of life. On the other hand,the war appears to have accelerated the dissolution of the uneconomic influences of the caste system in India that was going on before the war. The Indian soldiers drawn from villages, the strongholds of caste, which they had probably never left before in their life, dealt a severe blow to caste in the very act of proceeding to the different parts of the world in large numbers. Again, as Maine explains, it is the emigration of single families or individuals, as distinct from the transplantation of an entire village or caste section, to a great distance from the original home, that is the most effective destroyer of caste and local custom.* These soldiers underwent varied experiences in distant and different lands, learnt new ideas, and became infused with a new spirit. Returning once more to their villages, they are unconsciously doing much by example to break up the inertia and the uneconomic influences of caste which prevailed in the villages before. Anyone, who has seen such villages before the war and since the armistice, and marked the rise of new ideas and a new spirit, full of economic significance, will realise how much the war has furthered the removal of the economic disadvantages of caste.

The acceleration of the economic transformation of India resulting from the war becomes evident also from

* **Village communities, p. 39.**

the considerable changes in those aspects of India's economic life which Mr. Ranade emphasised. These, however, are mere tendencies whose strength can be appreciated only by watching them, and any statistical measurement or proof, in most cases, is impossible. While Mr. Ranade had pointed out that production was almost stationary, Sir T. Morison explained the change which had taken place in this respect. It appears from Mr. Shirras' table relating to the growth of business in India that the pre-war pace of the increase in total production was merely kept up during the war.* But this was due mainly to the adverse influences on foreign trade and to a retardation of the rate of increase in agricultural produce, and the advance in total production would have slackened had it not been for the substantial increase in the production of manufactures. The stimulus given by the war to the growth of large-scale industries of the Western type has been examined before, and it becomes evident that the progress in this respect would have been slower if the war had not taken pace. Professor Mukerji hopes that India's economic evolution will proceed along lines radically different from those in the West, *viz.* the development of cottage industries. It has not been possible to analyse the effects of the war on India's handicrafts in the preceding pages, but it becomes evident that the stimulus afforded by the war to large-scale industries has meant that the country has taken a further substantial step in the direction of an approximation

* **Indian Finance and Banking, p. 443ff.**

to Western conditions. This industrial development has been accompanied by, in fact has been rendered possible only by, a greater mobility of labour and capital. Mr. Ranade had emphasised the immobility of labour and capital in India. The conditions in these respects were already changing before the war, and the improvement has been much more marked since the war. It is believed that the migration of villagers to towns seeking employment has substantially increased since the last census taken in 1911, and especially since the war. In any case, there seems to be little doubt that the population of the largest trade and industrial centres has considerably increased during the last four or five years. Any statistical proof or measurement of this tendency can be afforded only by the new census to be taken next year. It is true that a large permanent class of industrial workers has not yet been formed. The main reason for this deficiency appears to have been the squalid, insufficient and insanitary housing accommodation for them. The war, however, has given a considerable stimulus to improvements and extensions of towns, especially of capital cities, and it appears that these defects will largely be removed in a comparatively short time, and that the main obstacle in the way of the existence of a permanent class of wage-earners will largely disappear. The industrial boom resulting from the war, the surprising increase in company flotations and the comparative ease with which they were financed, described above, show how much the war has done to increase the

mobility of capital. It is true that a part of the improvement resulted from the inflation of currency and the fall in the purchasing power of the rupee, and to that extent was deceptive, but a part of the improvement appears to have been real and full of economic significance.

More evidence is forthcoming to show that the war has hastened the pace of the industrial revolution in India. Sir T. Morison pointed out before the war that one proof of it was that the export of manufactured articles increased more largely than the export of raw materials, and it has been explained above that this feature became much more prominent during the war. Again, while Mr. Ranade maintained that prices, wages and profits were to a large extent customary and fixed, Sir T. Morison explained the change which had taken place, and how they were becoming more and more competitive. This change has been considerably enhanced by the war. If custom instead of competition, as Mr. Ranade contended, had been the controlling principle of India's economic life, the rise in prices resulting from the inflation of currency would not have made itself felt throughout the country. It is true that the rise was not quite the same in the different parts of the country, but the extent of the rise was so nearly the same in all the parts as to show that competition had become the motor to a greater extent than before. As regards profits, their customary nature had largely disappeared before the war, and while the total profits of most of the enterprises had

increased, the tendency for the margin of profits on each transaction was to diminish. During the war large profits were earned in several industries. This was the result partly of the continuous rise in prices, and partly of the restrictions upon competition imposed by the abnormal circumstances of the war, and it seems that custom had very little to do with them. But the rise in wages, although lagging behind the rise in prices more than in Western countries, has perhaps been the most remarkable feature of the war. When the war was in its early stages, Professor Mukerji wrote that strikes and lockouts were industrial diseases from which India was happily almost free, that India stood for more equal distribution of wealth, less luxury and more brotherhood, less industrial conflict and more co-operation, and that this was India's message to the West.* Since the end of the war it is found that numerous and prolonged strikes and lockouts are occurring all over the country, that trade unions similar to those in the West are being rapidly formed in large numbers, and that even trade-union congresses are being held. This is perhaps the best evidence to show that the war has quickened the approximation of economic conditions in India to those in the West. Other evidence in the same direction is the great success of the war loans, the growth of the co-operative movement, and the banking developments that have arisen out of the war. It is true that the success of the loans was partly due to the

* Foundations of Indian Economics, pp. 459-61, 465-7.

inflation of paper currency and credit, but it appears that they were partially successful in reaching those people, who had previously kept all their cash in boxes instead of investing it.

The war also made clear the full extent of the economic transformation taking place in India since Ranade's time. The main characteristic of the modern industrial world is the interdependence of all its parts as contrasted with the isolation and self-sufficiency of the economic units under the old industrial order. This interdependence must precede production on a large scale, and as Professor Marshall explains, is an evidence of the central unity between the laws of nature in the physical and the moral world. "This central unity is set forth in the general rule that the development of the organism, whether social or physical, involves a greater subdivision of functions between its separate parts, on the one hand, and on the other, a more intimate connection between them." The war has made India's economic dependence upon the other parts of the industrial world to be generally recognised more than before. For some years before the war, India's foreign trade had been expanding substantially, and the fact was welcomed with hardly any thought to India's progressive dependence upon other countries that it showed. This dependence, however, was fully recognised when the war affected the foreign trade adversely. India was dependent upon the Western markets for the sale of a large part of

her agricultural produce, and it was only when some of these markets were fully or partially closed to her on account of the war and her export trade suffered a considerable loss, that her dependence upon them was fully appreciated. The loss to her export trade even after the cessation of hostilities, largely on account of the conditions resulting from the war, *viz.* the inability of Central Europe, India's best market before the war for some kinds of her agricultural products, to purchase them in the quantities that it did before the war, the over-stocking of the American and other European markets and the commercial crisis in Japan, has brought this dependence still further home to the minds of the public. However, the curtailment of imports, essential for consumption and further production, that caused considerable hardships and serious difficulties as explained before, made people realise more fully India's economic dependence upon the other parts of the industrial organism than any other factor. This was realised even by the uneducated villager, who had to undergo some hardships on account of the disproportionate rise in the prices of the imported goods which he consumed, such as piecegoods, kerosene and petty articles of comfort.

The other matters, in which the war made evident the change which had been proceeding in India, more than had been generally recognised before the war, were railway communications and taxation. The extension of the former linked up the different parts of the country so gradually

that its result, *viz.* the removal of the fear that a considerable scarcity of essential commodities might exist in some parts along with their relative abundance in other parts, was welcomed without much thought to its economic significance. It was only when the difficulties of distribution arose during the war on account of the shortage of rolling stock and the increased demand for transport facilities that the extent of the economic unification of the country resulting from the creation of the network of the railway system was fully realised. Similarly, the growth in the taxable capacity of the community became generally evident only when it became necessary to resort to a substantial increase in taxation in order to meet the higher expenditure occasioned by the war. If custom had been the controlling factor in India's economic life, it would hardly have been possible to raise the level of taxation without causing serious difficulties.

These experiences of the war throw a new light on the controversy referred to in the introduction, *viz.* whether the principles of Political Economy as developed in the West are applicable to India, or whether India must develop a Political Economy of her own. The experiences appear to be opposed to the belief of economists of the school represented by Professor Mukerji that the economic evolution in India will proceed along lines different from those in the West, that labour and capital will not concentrate in large towns, and that manufactures will

be combined with agriculture, in the same hands, because, as seen above, as a result of the war, India has been passing through a further and important stage in an industrial revolution similar to that which took place in England in the early part of the last century and later in the other countries of Western Europe. All the tendencies appear to be in this direction, and this means that the principles propounded by Western economists will be more and more applicable to India. Bagehot confined Political Economy, which he called English Political Economy, to the generalisations made upon English industry, shaped by the industrial revolution and the development of international commerce, and he described all other industrial conditions as pertaining to a pre-economic era, in which the economic relations of society were based upon custom. It has been examined above, how custom is now far from being the guiding principle of India's economic life, and how competition has been becoming more and more the controlling factor. It is therefore impossible to relegate India to a pre-economic era.

It is, however, necessary to draw attention to two main considerations. Although it appears that the progress of the industrial revolution in India will be similar to that in Western Europe, agriculture will continue to be far more important in India than in the West. However it seems that even the agricultural methods in India will gradually tend to approximate to those in the West. But,

it means that those parts of the economic reasoning expounded by English economists which have been based upon the consideration of the conditions of agricultural organisations, need to be developed further. These economists have given a greater attention to the problems of large-scale and organised industry than to those of agriculture, and therefore the theories expounded by them, although true, are in some cases incomplete. For instance, they do not appear to have given sufficient attention to the fact that chronic indebtedness has been a prominent feature of almost all agricultural communities since the days of the ancient Roman Republic. One is therefore apt to be misled into believing that the indebtedness of the Indian cultivator, of which so much is heard, is a feature peculiar to him. It is in this direction, therefore, that the economic science developed by English economists requires to be further developed, and this is a task which should appeal to Indian economists.* Secondly, although economic reasoning is capable of a general application, it should be borne in mind that, as explained before, it holds good and professes to hold good, only when certain premises are granted. Therefore, in each particular case, it should be examined how far the premises involved in

* The investigations that are being conducted at the Madras University under the guidance of Dr. Gilbert Slater are an instance of this kind. See the Economic Studies pulished by that University. See also Dr. Mann's Economics of an Indian Village, published by the Bombay University, and Mr. Jack's Economic Life of a Bengal District.

it agree with the actual conditions prevailing in India, and if they do so, in a sufficient degree, the conclusions based upon them can be accepted as holding good in the case of India. In a few cases, it may be found that the premises do not yet square fully with the existing Indian conditions and then the conclusions may be modified accordingly.

Further, it is necessary to guard against believing that particular economic theories do not hold good in the case of India, because the conclusions derived from them may not appear to be true of the country at particular times, without investigating whether they are counteracted by artificial interference. This was especially true of the war, because, during its continuance, economic interests were completely subordinated to those higher interests for which it was fought, and the State interfered with the free play of economic forces far more than it did before. The interference appears to have been less in India than in Western countries, mainly because India, on account of her economic deficiencies, and her great distance from the main theatres of military operations, could not take part in the conduct of the war to the extent that the latter did. In most Western countries, the State continued the interference vigorously, even after the cessation of the hostilities, in an endeavour to check the evils generated by the interference resorted to during the progress of the struggle, and in this case also the extent of the state interference in India appears to have been

appreciably smaller. Nevertheless, the artificial restrictions imposed upon the free play of economic forces have been very important, even in India. These have been explained before in the course of the analysis and the examination of the effects of the war, and all that seems possible, and indeed necessary, to do here is to give a few instances in order to explain the nature of their counteracting effect upon the operation of economic principles which have been described as statements of mere tendencies, whose operation may be counteracted by opposing circumstances. Thus, the operation of the theories of international trade and values, and of the monetary circulation appear to have been much disturbed in this way. Nominally, the Indian Government continued to adhere to the doctrine of free trade as firmly during the war as it did before, but actually many restrictions were imposed upon the freedom of trade, such as an absolute prohibition of export, a prohibition with a system of licenses, a rationing of export and of shipping space, revenue export duties, and measures involving higher prices for foreigners, than those of the inland market. Moreover, although the import tariff continued to be purely a revenue tariff, the imports fell off on account of the restrictions imposed by the countries producing them. These restrictions also disturbed the operation of the theory of comparative costs. As India continued to adhere to the principles of free trade, one was apt to think at first that the fact that certain commodities were manufactured in India during the war,

which it did not pay her to produce before, meant that manufacturing them in the country had become the cheapest way of obtaining them. Such a conclusion, however, was not necessarily true, when it was impossible to import them at all, or in sufficient quantities, on account of the restrictions of the countries manufacturing them.

These restrictions disturbed also the operation of the theory of international values. According to this theory, the foreign exchange values of a monetary unit tend to coincide with the purchasing power parities, and any divergence from the point of equilibrium is soon corrected by the resulting increase or decrease in exports and imports, as the case may be. But, it has been explained before that the sterling value of the rupee fluctuated most violently after the middle of 1918. This did not, however, mean that the above theory was not applicable to India. The enormous fluctuations were due to the interference with its operation, in the shape of various kinds of restrictions upon foreign trade, private operations in the exchange and the free movement of the precious metals, and of the sale of Reverse Councils. If trade between two countries is more hampered in one direction than in the other, the value of the money of the country whose export is relatively more restricted will fall in the other country, below the purchasing power parity. Again, one of the principles of money is that at a particular level of prices no more

money can be forced upon the public than the public asks for. From this, it seems to follow that a government cannot inflate the currency, but as such an inflation has actually taken place in India, it would appear at first sight that the principle does not apply to India. Such a conclusion, however, is unwarranted, because the theory holds good only when the government does not artificially create money to provide itself with purchasing power. But, when it does so, an inflation of currency and a rise of prices are bound to occur in the way explained before. Many more instances of similar factors counteracting the free play of economic forces can be given, but the instances already given will probably suffice to make clear the nature of the operation of economic laws and the factors to be taken into consideration in examining their application to Indian conditions.

This state interference and action produced several economic losses as well as gains, and the question naturally arises whether India has gained more from the war than she has lost in the development of her economic activities. It is very difficult to give a conclusive answer to this question, because it involves a comparison of India's actual economic position to-day, with what it would have been if the war had not intervened. Any estimate of the latter position lies entirely in the realm of conjecture, still an answer to this fundamental question may be attempted.

It was mentioned before that for some years before the war India's export trade had been expanding continuously and rather rapidly, and it is probable that, but for the war, the expansion would have continued, perhaps at a somewhat slower rate. For, previous to the outbreak of the war, trade and industry in the countries of Western Europe and in the U. S. A. had been developing fast, further great developments were either being carried out or planned, when the war broke out, and the demands of these industrial populations for foodstuffs and raw materials produced in India would have continued to be great. India would have found it possible to meet these demands, as substantial improvements in her methods of agriculture had been projected. But, it was noticed that her export trade received a considerable setback from the war, that until 1918-19 its value did not reach the figure which it had attained in 1913-14, and that it met with another check in 1920. The check to the import trade given by the war was even greater, and its partial recovery was entirely in value owing to the progressive rise in prices, while the volume continued to decline, imposing considerable hardships upon the masses of the population. Considerable stress has been laid above upon the improvement in the general standard of life as one of the most urgent needs of India, and a sudden and considerable check to imports was bound to have a prejudicial effect upon her standerd of life, extraordinarily low as it has been. Her import trade had been rapidly expanding

both in value and volume along with the export trade before the war, and, if the war had not intervened, it would have probably continued to do so on account of the stupendous industrial activities of the Western countries, especially of Germany, requiring larger and larger foreign markets. The result of a serious reduction in India's import trade during the war was to increase the balance of trade in her favour, and this has led to the incorrect belief, popularly held, that India's foreign trade enjoyed an immense prosperity during the war. This belief will be dispelled, if the figures of the value and volume of the foreign trade during the war are compared with similar figures for 1913-14, as was done in the first chapter, and if the probabilities of the expansion of the trade, if the war had not occurred, are taken into account. Moreover, the increase in India's favourable balance of trade had the effect of merely giving to her people large quantities of paper money and precious metals, which were largely hoarded, while the real test of an increase in the prosperity of a country consists in an increase in her consumption of goods which go to make up a civilised standard of life.

Thus it appears that the consequences of the war for India's foreign trade were distinctly adverse. However, a partial compensation for this disadvantage was found in the stimulus which the war gave to industrial development in India, by curtailing foreign competition, and by

forcing the Government to encourage that development in ways, which it would never have followed but for the necessities imposed by the war. One desirable outcome of this development was that, as mentioned before, the proportion of the export of fully or mainly manufactured goods increased during the war, as compared with the export of foodstuffs and raw materials. If there had been no war, industrial progress in India would have been much slower than it has actually been, because the foreign competition in the Indian market would have grown in fierceness, and it would have been very difficult to induce the Government to abandon its strict laissez faire policy, and the result would have been that, although the export trade would have continued to expand considerably, it would have consisted almost entirely of foodstuffs and raw materials. However, it has been mentioned before, that the industrial development, that has been brought about by the war, has been less sound and satisfactory than it appears to have been at first sight, because it has been substantially the result of artificial measures, which have had to be abandoned gradually with the termination of the war, and because it has largely been carried out by foreign firms in India. Still, in so far as the war has made the Government inaugurate a permanent policy of rendering an active assistance to industrial expansion in India, by bringing home to it, the grave dangers resulting from India's almost complete dependence upon other countries for manufactures essential for civilised life,

and in so far as it has promoted indigenous industrial enterprise, the war may be said to have brought a permanent good to the country.

Proceeding to the public finances of the country,it was seen that the revenues of the Government increased more substantially than they would have done had there been no war. However, it was found that this increase was only partially real and satisfactory, and that otherwise it was illusory as in the case of the railway revenue to some extent, and the result of an increase in the burden of taxation and of the inflation of currency. It may be said that the increase in the revenues and the success of the increase in taxation made it clear that the taxable capacity of the people and the financial strength of the Government were greater than had been supposed before the war. But it should be explained that, while the increase in the burden of taxation was severely felt by the masses so far as it affected them, and was considerably felt by the classes, the increase in the revenues failed to benefit the country, from the economic point of view, because it was utilised for meeting the immense increase in the military expenditure which had already been very large before the war, for paying the interest on the loans contracted for making large financial contributions to the Home Governnment for the prosecution of the war, and for meeting the increase in the expenses of the civil establishments rendered necessary by the rise in prices. The expenditure on the

expansion of education, sanitation, medical relief and irrigation, most vital to the economic advance of a country, which occupies a deplorably low position in these matters, far from being increased, was cut down during the war. If the war had not taken place, the Government would have been obliged to allot much larger sums to these urgent reforms in response to the demands of the people, and India's position in these matters would have been better than what it is to-day. But against these losses should be set the advantage of a fairer incidence of taxation resulting from the triumph of direct taxation and the application of the principle of graduation to it. It was noticed that before the war the richer classes did not bear a fair share of the total burden of taxation, which was based more largely on indirect imposts and the principle of proportion. It is true that even before the war there was a tendency in Western countries to make the burden of taxation fairer by the above methods, and that even if there had been no war, that tendency would gradually have made itself felt in India also. But, its operation would have been very slow and halting, and the fact that it was considerably hastened by the necessities of the war must be reckoned to be a permanent advantage accruing from the war. Again, the recognition, to be credited to the war, that the taxable capacity of the country is greater than was supposed before the war, is also an advantage, now, as a part of the proceeds of the revenues from it is being applied to the promotion of the vital reforms

mentioned above. But, at present the country cannot secure this advantage to a substantial extent, because most of the proceeds are used up for meeting the increased military expenditure and the expenses of the civil establishments, and for paying the interest on the war debts. The Government seems to consider the continuance of the large military expenditure necessary, the expenses of the civil establishments have continued to increase owing to the continuance of high prices, and the burden of the war debt has not diminished. It is obvious that India would have escaped from these burdens if the war had not taken place.

Similarly, but for the war, the Government would not have experienced the immense Ways and Means difficulties that it actually did. The course of its Ways and Means operations had been quite smooth before the war, and at the outbreak of it there was not the least prospect of its being disturbed. In utter contrast to this, it was noticed before that the Government had to make huge war disbursements on behalf of the Home Government, that it had to cash large amounts of Council drafts, largely on account of the increase in the favourable balance of trade due to the curtailment of imports, and the serious artificial check to the natural flow of the precious metals to India, that it found it extremely difficult to secure adequate funds to make these enormous payments, that it had to resort to several objectionable expedients

for this purpose, the most undesirable among which was the watering of the note issue, that it had to meet silver crises by making the notes practically inconvertible, and that its budget estimates of Ways and Means became altogether nominal and were invariably and entirely upset. The currency and exchange troubles from which India is still considerably suffering have been largely the result of these war operations of the Government. Yet, these losses also are partially counterbalanced by certain advantages attributable to the war. Before the war, the Indian loan market was regarded to be very narrow, the Government depended upon the London market for most of its borrowing operations for the purposes of capital expenditure, and, if the war had not taken place, this depencence would have continued at least for some years. But the remarkable success of the war loans has revealed not merely the substantial strength of the Indian market but also its possibilities, and thus the war has shown that the Indian market is capable of taking the place of the London market to a substantial extent, in meeting the capital requirements of the Government, especially if efforts, similar to those made during the war, are resorted to. Again, before the war, most of the Government balances were locked up in its independent treasuries, and only a small part was kept with the Presidency banks, which thus contributed to the seasonal monetary stringency. War finance, however, rendered it essential for the Government

to maintain far larger balances with the Presidency banks, and this beneficial policy is now being developed further. It is true that a few months before the war, the Government was contemplating the maintenance of larger balances with the Presidency banks, but the whole history of this question seems to lead to the conclusion that, had it not been for the necessities of the war, this liberalisation of the Government policy regarding its cash balances would have been effected to a far less extent then has actually been done.

The loss inflicted by the war on India in currency and exchange matters has been serious. Before the war, her currency and exchange system though artificial in the sense that it was managed by the State at almost every stage, and though deficient in several respects, at least possessed the virtue of an internal and external stability. Moreover, the people were gradually feeling more and more confidence in the note issue, the circulation of which was not increased beyond the extent justified by that confidence. If the war had not taken place, as far as can be seen, this comparatively satisfactory state of affairs would have continued. No abnormal increase in the balance of trade would have taken place, there would have been no reason for starving India of gold, the Government disbursements would not have become abnormal, it would have had no reason for watering the note issue and making it practically inconvertible, there would have been no unprecedented

demand for silver, and its price would not have soared to dizzy heights. Consequently, it seems that the stability of the Indian currency and exchange system would have been preserved, and that any temporary tendency towards instability could have been corrected without much difficulty by means of the then existing elaborate Government machinery. Moreover, the popular confidence in the note issue would have increased, as the circulation of notes, instead of outstripping it, would probably have kept pace with it, and a healthy beginning would have been made towards the economy of the precious metals. It was seen that the war produced results entirely the opposite of these. India's starvation in the matter of gold, in the supposed interests of the Empire, and the Secretary of State's action of allowing the Government of India to issue vast quantities of notes against unrealisable paper credits in London instead of insisting that the payments for India's exports of war and other materials should be made either in the precious metals or in securities acceptable to India, have been detrimental to India's economic interests. The unparalleled fluctuations in exchange and the frequent changes in the Government policy have been affecting her trade and industries adversely during the period of transition, which will be prolonged in the existing economic conditions of India, although it is true that the adverse affect will disappear when the period of transition is complete, and the costs of production become adjusted to the

new level. Again, the rise in prices resulting from the war operations mentioned above has been severely affecting the masses in India, and the prices cannot come down substantially unless the currency is materially deflated. These disadvantages are serious, but they also are to some extent neutralised by the advantages which the war has secured for India. One of these, is the minting of gold in India and its free circulation. Indian opinion demanded these facilities for nearly twenty years before the war, the Government of India favoured the demand, but was not allowed by the Home Government to meet it, and if the war had not taken place, it would probably have remained unfulfilled. But the necessities of the war forced the hands of the Home Government, and India may be said to have secured this important gain, although at present the minting of gold has been temporarily suspened. Other advantages secured by India are the urgent needs which the war has revealed, for giving more powers to the Government of India in currency and exchange matters, instead of keeping it entirely under the leading strings of the Secretary of State, and for keeping at least a large part, if not the whole, of the reserves of the Government of India, in India instead of in England.

With regard to banking, the war at first gave a set-back to the progress of the postal savings banks, by causing a lack of confidence in the masses of the population,

but in other respects the effects of the war have been beneficial. Banking operations demanded an extra caution during the disturbed times of war, and it did much to strengthen the general banking position of India. Another important outcome of the war has been the creation of the Imperial Bank of India, by the amalgamation of the Presidency banks. For many years before the war, the Government had been repeatedly urged to assist in the formation of such a bank, but the Secretary of State was not favourable to the proposal, and had it not been for the war, India would probably have had to wait for many years before securing the establishment of a central bank. Thus it will have become evident that one of the most valuable and permanent advantages, which the war has bestowed upon India, is the fact that it has remarkably changed the angle of vision of the Government in several respects, and led it to inaugurate policies, which it had been repeatedly urged by the public to adopt before the war, but which it had been most reluctant to accept.

Thus, the advantages which the war has bestowed upon India in economic matters have been many and important, but the losses inflicted by it have been more numerous and more far-reaching in their effects, and therefore the conclusion appears to be that, so far as her economic life is concerned, India has lost more than she has gained from the war. Such a conclusion need surprise none, because it is the natural result of any war, and much more

so of a prolonged, devastating world war. Such a war, waged to achieve aims other than economic, is bound to disorganise seriously the whole economic life of all countries concentrating all their resources upon its vigorous prosecution, and to inflict heavy economic losses upon them. This has been the case with all the belligerent countries in this great war, with the sole exception of Japan, which enjoyed a large measure of economic prosperity during the war, because it secured all the advantages of being an ally of the British and the French, without most of the disadvantages of that position. India, however, could not be such an exception, because, as shown in the chapter on her contributions to the war, she concentrated her energies and resources upon the conduct of the war, much more fully than she could fairly have been asked to do. Further, it should be borne in mind, that the above conclusion relates only to the economic consequences of the war for India. This war was fought for ends other than economic, and in other spheres India has secured from the war most valuable advantages, which more than neutralise the economic losses which she has borne. Quite apart from the removal of the danger of world domination on the part of Germany, for which the war was waged, the war is responsible for the remarkable progress in India's political status and national unity, which has already been made, but which, if the war had not taken place, would have taken many years to achieve. It is not the purpose of these pages to deal with these

consequences of the war for India, and therefore it will suffice to say that the economic lossess which the war has inflicted on India may well be considered to be the price paid for her remarkable non-economic gains.

Thus, it appears that a kind of balance-sheet of the economic gains and losses resulting from the war may be drawn up and tabulated as follows :—

Losses.	Gains.
Setback to exports.	Development of industries.
Setback to imports.	Increased export of manufactures.
Raised level of taxation.	Improved incidence of taxation.
Curtailment of social expenditure.	Graduation of taxation.
Rise in expenditure (military, interest, salaries, wages, etc.).	Widening of the loan area.
Inflation of currency.	Weakening of the independent treasury system.
Discredit of currency notes.	Gold mint.
Instability of exchange.	Improvement of the banking system.
Temporary injury from raising exchange.	Increase in the economic powers of the Government of India.
Rise of prices.	
Net loss.	Large non-economic gains.

It is obvious that the above conclusion relates to India's economic conditions as they exist to-day. They will undoubtedly be altered considerably in the near future, and the question arises whether any conclusion can be arrived at regarding the possibilities of that future. It is very difficult to answer it, but it appears that, on the whole, the gains will be more permanent than the losses. Although the extent of the former may be reduced in some cases, it seems that they will endure on the whole, while the losses, in the majority of cases, are likely to be made up either wholly or partially.

The favourable and adverse factors in India's industrial progress have been fully examined before, and it appears from them that, although the progress achieved during the war may be lost in some directions, in others it is likely to continue though at a slackened rate. The artificial stimulus to industries afforded by the war has disappeared, and when the industrial conditions in the United Kingdom become quite normal, when the industries of Central Europe cease to suffer from the lack of raw materials and from disintegrating political and economic influences, and when the Japanese industries shake off the effects of the recent financial crisis in Japan and are re-organised on a sounder system, the competition of foreign industries with the Indian industries in their home market will become keener. But, as explained before, vigorous efforts are being made to remove the industrial deficiencies of India with the support of the Government, and they may be expected to continue. The growth of free and compulsory primary education, the initial steps for which have already been taken in restricted areas, the extension and improvement of housing accommodation in large towns to which a considerable attention is being paid, and the expanding welfare work, will tend to make industrial labour more efficient, permanent and ample. The existing shortage of skilled mechanics and foremen will be substantially removed by the measures which are being taken to increase the facilities for training, and the inducements for attracting

the right sort of men. The growing attention that is being directed to industry rather than to trade, Government employment or the liberal professions by educated Indians of the higher classes, and the training which they are receiving for the purpose, will tend to increase the number of experienced Indian entrepreneurs. The growth of the investment habit and the number of industrial banks will materially obviate the difficulties of securing an adequate capital for sound industrial propositions. The technical assistance and guidance required for establishing or conducting concerns according to the most modern and efficient methods will be supplied in a larger degree by importing exports from abroad, and by the technical services which are being created by the Government. The decision of the Government to purchase all its stores in India as far as possible will give a considerable and permanent stimulus to industrial development. The organisation of the central and provincial departments of industries will tend to produce the same effect. Thus, it appears that the industrial progress will continue, probably at a slower rate, although it cannot be denied that, as explained before, there are numerous difficulties in the way, and that the result will be largely dependent upon a cordial co-operation between the industrial community and the Government

The second gain from the war, the increase in the export of manufactures, is likely to be reduced to some extent, because, as mentioned in the first chapter, it was

largely the result of the export of jute and leather goods for military purposes. But, the gain will not disappear entirely, because it seems that, as a result of the war, India has secured important potential markets, near herself, especially Mesopotamia and East Africa, and that the industrial progress in India will enable her gradually to develop these markets.

The improvement in the incidence of taxation and the introduction of graduated taxation are gains, which will not only endure, but which may be expected to increase. Before the war, the richer classes did not bear their fair share of the burden of taxation, and even now, they can hardly be said to do it, although the conditions in this respect have considerably improved, and it seems that by far the larger portion of the increase in the burden of taxation that will be necessitated by the growing expenditure in the near future will fall upon them. Again, the fact that proportional taxation is far from involving an equality of sacrifices is coming to be recognised more and more. In these matters, India's approximation to the Western standards, which themselves have been raised immensely as a result of the war, is likely to be rapid.

Again, the propaganda already resorted to, in order to make the war loans successful, will very probably prove to have produced a permanent effect in promoting the investment habit, and this habit will grow, so that equal

sums will be available for productive purposes, with diminishing effort. Numerous instances are to hand, of land holders, who used to keep their savings in cash in strong boxes, and who were induced to purchase war loan with great difficulty. The regular receipt of inrerest, howevei, appeals to them now, and it is probable that they will take up other loans in the future, with the same facilities, but less propaganda.

Although the coinage of gold is temporarily suspended at present, it seems that the Bombay branch of the Royal Mint will be permanently re-established, because the Smith Currency Committee has recommended it, and because the proposal has been accepted by the Government. The other gains from the war, *viz.* the development of the banking system and the weakening of the independent treasury system are inter-connected, and they may be expected to increase considerably in the near future. The growth of industries and of the investment habit and the banking development will stimulate each other, and, in addition, the Imperial Bank Act of 1920 has provided for the establishment of 100 new branches of the Imperial Bank during the next five years. The Government has declared its aim of keeping larger and larger balances with the Imperial bank as it goes on establishing branches and increasing its strength. Hence, the independent treasury system may be expected to weaken progressively in the near future, the branches of the bank replacing the Government

district treasuries to an increasing extent. Although the goal of the total abolition of the system, so as to bring India to the level of the advanced countries in this respect, is yet somewhat distant, substantial steps in this direction will be taken during the next few years. The last gain from the war, *viz.* the increase in the powers of the Government of India in the economic sphere, will also increase with the growth of constitutional government and of the strength of its various organs in the country.

Proceeding to India's losses from the war, it is probable that in a few years foreign trade will regain a large part of the lost ground. The shipbuilding activity that is being carried on in the United Kingdom will re-establish the normal conditions of shipping in a comparatively short time, the gradual economic recovery of Central Europe will enable it to purchase India's products, largely to the extent that it did before the war, the existing prohibition of the export of foodstuffs will be removed as soon as the necessity for it disappears, and thus the export trade may be expected to revive. Similarly, the import trade also will improve, especially in its volume, when industrial conditions in the United Kingdom become normal, when the industries of Central Europe, being supplied with raw materials and freed from the withering influence of adverse political forces, revive, when the industries of Japan are re-constructed on a sounder basis, and when real peace is established in the sense of a friendly co-operation of all the nations for

the recovery of the economic life of the world. As regards the future trade relations between India and Central Europe, it may be pointed out that it is being more and more recognised by the victorious powers, that a country organised for an export of manufactures cannot maintain itself without an unobstructed access to the markets of the world, that the recovery of the world's economic life will be most promoted by the greatest possible freedom of trade and by the removal of all discriminations between goods according to their country of origin, and that all countries should be allowed to buy raw materials and food on equal terms in all the markets of the world. It is therefore probable that, outside any scheme of Imperial Preference designed to benefit the other parts of the British Empire in their trade with India, all other countries will have the same opportunities of trading with India, and that no special discrimination will be made against Central Europe.

It is probable that the economic loss resulting from the curtailment of social expenditure will be fully made up in a few years. A beginning has already been made since the cessation of hostilities, and there is hardly any divergence of opinion regarding the urgency of progress in these matters. The fact, that they will be under the control of Indian ministers under the new Reform Act and will be their main concern, is a favourable factor in the situation, and it is likely that the restricted areas, in which free and compulsory primary education is being introduced, will

expand considerably in the near future. However, the loss in the form of the increase of the total expenditure of the Central and Provincial Governments will continue. It will be explained presently that prices are not likely to fall in any considerable degree during the next few years, and this will be an important factor in keeping up the total expenditure. For this reason, the wages which the Governments have to pay will remain much higher than those before the war, and the salaries and expenses of the civil establishments, far from being reducd, are likely to increase further in the process of the growth of the various organs of government, which will probably be much more rapid in the near future. The military expenditure may be appreciably reduced in the near future, but it will remain far higher than the pre-war figure. The Esher Committee's recommendations concerning military re-organisation, the commitments of the Home Government in Mesopotamia and Persia, and the disturbed situation in Afghanistan and Central Asia appear to be factors adverse to any substantial curtailment in the present level of the military expenditure. In addition, a considerable expenditure on the creation of an Indian navy is being suggested on the ground that the war, and especially the exploits of the Emden, have shown the necessity of such a navy for India's safety. The interest payments are likely to mount higher because the Government, far from being able to reduce the public debt enhanced by the war, will have to borrow more for productive works, such as railways,

irrigation and public works. However, the possibilities of a normal growth in the revenues appear to be very limited, as explained before, and therefore the present level of taxation, raised by the war, will probably have to be raised further.

The practical possibilities of deflating the currency seem to be greater in India than in most European countries, because the increase in note circulation and bank credits, without any real backing, has been much less in the former than in the latter. A little deflation has already been brought about by the sale of gold bullion and of Reverse Councils, which were to some extent paid for by notes in India and cashed out of the reserves in London.* But, the possibilities of deflating the currency in these ways, are very limited, because it is imposible to mobilise fully the reserves in London, and beacause the Councils had to be sold at very unfavourable rates and involved considerable speculation, export of capital and tightness in the money market. There are only two other ways available for this purpose. In the first place, the Government may levy such high taxes or obtain such large loans from the people as to acquire a sum of money in excess of its expenditure, and may use the surplus for destroying an equivalent amount of purchasing power in the shape of notes. It is evident that this remedy is

* See the Report of the Indian Delegation to the International Financial Conference at Brussels 1920, p. 16, para 8.

impracticable in India. On the one hand, as explained before, the needs of current and capital expenditure will increase; on the other, the possibilities of a considerable increase of taxation and of securing large sums from the public in the form of loans in the immediate future are limited. On the whole, it appears that the possibilities of obtaining sums of money by these methods beyond the growing needs of the expenditure are very slight. Secondly, deflation will be achieved, if the banks impose such sharp restrictions upon lending that the sums lent are less than the actual savings deposited with them, and if the surplus is used to destroy an equal amount of purchasing power. This policy, however, would depress trade and industry, and as the revival of the former and the development of the latter are India's urgent needs, it is obvious that the policy is not at all likely to be put into operation. The increase in production resulting from the general economic development of the country may ultimately prove commensurate to the increase in the means of payment which has already taken place, but the completion of the process will require a considerable time, and in the meanwhile the total means of payment are likely to be increased further. Therefore, it appears on the whole that, although the general level of prices may fall appreciably during the next few years, it will probably remain much higher than the pre-war level. The hardships of high prices, however, will largely disappear when wages, salaries and other contracts become fully

adjusted to the new level. The adjustment is proceeding in India at present and may be expected to be fairly complete before long, although it will require a longer time in India than in the Western countries.

Finally, the fluctuations of exchange and the loss resulting from it will also disappear. It has been explained before that the instability of exchange has been mainly the outcome of abnormal conditions of production and trade in the world, and as the efforts which are being made to revive them become successful, the abnormal fluctuations of exchange will be less and less, and will disappear ultimately, and the actual rates will tend to coincide more and more with the normal rate determined by the purchasing power parity.

Thus, the economic losses from the war, in the majority of cases, are likely to be made up either wholly or partially, while the economic gains will probably endure on the whole, although their extent may be reduced in some cases. Therefore, it appears that even in the economic sphere, apart from the large non-economic gains from the war, the balance will be more favourable in a few years, than it is to-day.

APPENDIX 1.

Foreign trade per head of population in $s.*

	1913	1919
Holland	454	267
Belgium	221	131
New Zealand	198	314
Switzerland	165	314
Australia	155	187
Canada	141	237
United Kingdom	128	213
Denmark	128	211
Argentine	125	..
Sweden	78	170
France	75	132
Finland	55	80
South Africa	53	59
U. S. A.	41	107
Italy	34	61
Brazil	26	32
Spain	22	..
Japan	13	38
India	6	9

*Statist, 20th November 1920.

APPENDIX 2.

Taxation per head of population in 1920.*
(Local currencies converted into $s at prevailing exchange.)

	Direct	Indirect
Belgium	8.3	6.9
France	18.4	16.2
Italy	3.6	2.0
United Kingdom	58.2	29.7
India	0.73	0.89
S. Africa	6.92	4.60
Holland	7.7	11.0
Spain	5.5	5.1
Switzerland	4.5	3.9
Sweden	13.1	5.1
Norway	20.9	7.9
Denmark	10.3	10.1
Finland	4.4	6.0
Germany	7.6	4.9
U. S. A.	56.5	
Japan	3.2	2.6

*Statist 11th December 1920, p. 933.

APPENDIX 3.

In 1903-4 in the United Kingdom indirect taxation produced 50·7 % of the revenues and direct taxation 49·3 %. In 1913-4 indirect taxation accounted for 42·5 % of the total. In 1918-9 it yielded only 30·20 % (or 18·63 if we include the figure of the excess-profits duty.) Taxation per head of population was stated to have been £3 10s. in 1913-4 and £16 12s. 10d. in 1918-19, of which £10 5s. 2d, came from direct taxation. (See Higg, Primer of National Finance, p. 70.)

APPENDIX 4.

Requirements for the service of debt in millions*

	Unit of currency	Service of debt 1913	Service of debt 1920	Percent of 1920 expenditure required for the service.
Germany	Mark	239	12,400	23.6
Belgium	Franc	147	1,067	12.0
France	,,	1,287	11,463	23.4
U. S. A.	$	27	1,052	15.4
Italy	Lira	688	5,346	21.7
U. K.	,,	33	345	29·1
Switzerland	Franc	9	90	14.9
Norway	Krone	17	35	4.6
Canada	$	15	..	
Sweden	Krona	39	106	12.2
Holland	Guelden	38	142	19.3
Japan	Yen	143	95	6.0
Denmark	Krone	14	49	14.6
S. Africa	£	5	7	18.0
Spain	Peseta	..	535	22.2
India	Rupee	..	122	5.5

* Statist 11th December 1920, p. 933.

APPENDIX 5.

Price of bar silver per ounce in London in 1919-20*

1919	Highest	Lowest	Average
April	49 9/16d.	48 9/16d.	48 7/ 8d.
May	58	48 9/16	52 1/16
June	54 7/8	53	53 29/32
July	55 9/16	53	54 1/8
August	61 3/4	55 3/4	58 27/ 32
September	64	59	61 11/ 16
Oct.	66½	62 3/4	64 1/16
Nov.	76	65 1/3	70 1/16
Dec.	79 1/8	73 1/8	76 7/16
1920			
Jan.	85	75 7/8	79 27/32
Feb.	89½	82	85
March	84	65	74 3/16

* Report of the Currency Department of the Government of India, 1919-20, p. 7.

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